

8. UNDERWRITING FEDERAL CREDIT AND INSURANCE

In a period of tight budgetary constraints, the Administration has been reexamining the role and design of Federal credit and insurance programs. In many lines of credit and insurance, the private market can meet societal demands and Federal intervention is unnecessary. However, in some situations Federal intervention can improve the market outcome. Last year, the "Underwriting Federal Credit and Insurance" chapter of *Analytical Perspectives* focused on these rationales and their application to particular credit and insurance programs.

This year, the chapter focuses on the next step in the analysis. Even when Federal intervention can improve on market outcomes in principle, it is necessary to judge whether the program is achieving these goals in practice. Thus, the Administration is highlighting measurement of program performance. What do these programs produce? What outcomes and net impacts do they have on society?

Cost is also a performance measure. For credit and insurance programs, it is a continuing challenge to understand and control the risks that the Government assumes and to measure the inherent cost. This is especially true in view of the rapid changes in financial markets and increasingly complex financial instruments. Ultimately, performance is measured by benefits (net impact) in relation to cost.

Budgetary constraints are also impinging on administrative resources and program structure, pressing program managers to find more efficient ways to originate, service, and collect on loans and monitor the financial risks of guarantees and insurance. In some cases, staff is diminishing despite rapidly growing portfolios. To address this problem, improved financial systems are being implemented, and various forms of private involvement are being explored.

I. Estimated Costs of Federal Credit and Insurance Programs

The Federal Government continues to be the largest creditor institution in the United States, with \$5.5 trillion outstanding at the end of 1995. Of this, \$163 billion is direct loans, \$727 billion is loan guarantees, and \$4,613 billion is insurance. Including the Government-sponsored enterprises (GSEs) pushes the total Federal and federally assisted credit and insurance outstanding to \$7.0 trillion.

Table 8-1 presents the face value and estimated future costs of the largest Federal credit and insurance programs and the Government-sponsored enterprises. The face value of these programs is the total amount of credit outstanding or the insurance in force. The future costs of these programs is the amount by which payments from the Federal Government to borrowers, guaranteed lenders, or insured parties exceeds the repayments, fees, premiums, and other cash inflows to the Government—whether by intent or in practice.¹ The costs shown in this table assume that program activity will continue following recent trends.

The amounts shown are not only costs or potential costs to taxpayers. They are also the means by which these programs reallocate credit in the economy toward

purposes and entities or individuals favored under the laws authorizing these programs and away from alternative uses. When the Federal Government guarantees loans, for example to students or small businesses, those borrowers move ahead of other borrowers in the credit queue, because the Federal Government bears the risk of defaults on their loans.

In volume, the fastest growth in Federal assistance is via Government-sponsored enterprises. These privately owned, federally chartered financial institutions are transforming mortgage markets; tapping capital markets to assist agriculture, education, and housing; making advances to depository institutions; lending for farming and rural development; and insuring borrowing for educational institutions. Also growing are loan guarantees and direct loans for home mortgages and student assistance, and disaster insurance coverage.

Federal costs for credit and insurance programs generally declined last year. Behind this improvement is the declining trend in long-term interest rates in recent years as the Federal deficit was reduced, the expectation that interest rates will continue to decline as the budget moves closer to balance, and the economic growth and prosperity documented in Chapter 2 of the *Budget—Supplement*, "Three Years of Progress." For credit programs, there has also been a widespread effort to reduce subsidies, now that the Federal Credit Reform Act of 1990 has raised awareness of them.

¹Under the Federal Credit Reform Act of 1990, the budget records as an outlay the cost of a direct loan or loan guarantee when the loan is disbursed. The cost is defined as the net present value of the estimated cash outflows from the Government due to the loan or guarantee over its life minus the present value of estimated cash inflows. Chapter 23 of *Analytical Perspectives*, "Budget System and Concepts and Glossary," explains concepts and terms used in credit budgeting.

Table 8-1. FACE VALUE AND ESTIMATED COST OF FEDERAL CREDIT AND INSURANCE PROGRAMS

(In billions of dollars)

Program	Face Value 1994	1995 Budget Estim. Present Value of Future Costs ¹	Face Value 1995	Current Estimates Present Value of Future Costs ¹
Direct Loans:²				
Farm Service Agency (excluding CCC)	49	15-21	43	13-19
Rural Electrification Admin. and Rural Telephone Bank	38	2-4	43	2-4
Agency for International Development	14	0-1	14	2-3
Public Law 480	12	2-3	12	2-4
Disaster Assistance (SBA & FEMA)	N/A	N/A	9	3-5
Foreign Military Financing	8	0-1	8	0-1
Export-Import Bank	8	3-5	8	1-3
Federal Direct Student Loan Program	*	11-15	3	6-9
Small Business Loans (SBA)	9	2-3	2	0-1
Other Direct	17	2-4	19	1-2
Total Direct Loans	155	37-57	² 161	30-51
Guaranteed Loans²:				
FHA Single-Family	303	(13)-0	318	(12)-0
VA Mortgage	155	4-6	154	3-5
FHA Multi-Family	79	5-6	83	11-14
Federal Family Education Loan Program	75	13-23	86	5-10
Small Business Administration	25	4-5	26	2-3
Export-Import Bank	17	6-8	18	3-5
Farm Service Agency	9	1-2	8	1-2
CCC Export Credits	12	4-5	5	2-3
Other Guaranteed	23	2-3	27	3-4
Total Guaranteed Loans	699	26-58	727	18-46
Federal Insurance:				
Banks	1,885	(5)-15	1,919	(6)-(4)
Thrifts	691	15-25	709	(2)-1
Credit Unions	253	.....	266	.....
Subtotal, Deposit Insurance	2,829	10-40	2,894	(8)-(3)
PBGC	950	20-40	853	30-60
Disaster Insurance	238	14-15	354	13-14
Other Insurance	484	13-14	512	11-12
Total Federal Insurance	4,445	57-109	4,613	46-83
Total Federal Credit and Insurance	5,299	120-224	5,501	94-180
GSEs:³				
Fannie Mae	744	.....	787	.....
Freddie Mac	567	.....	552	.....
Federal Home Loan Banks	140	.....	122	.....
Sallie Mae ⁴ .....	.....	.....	.....	.....
Farm Credit System	51	0-1	53	0-1
Total GSEs	1,502	0-1	1,514	0-1
Total Federal and Federally Assisted Credit and Insurance	6,801	120-225	7,015	94-181

¹ Less than \$500.00.² Direct loan future costs are program account outlays projected into the future plus the embedded loss from outstanding loans. Loan guarantee costs are program account outlays plus liquidating account outlays (and outlays from defaulted guarantees that result in loans receivable) projected into the future. Future insurance costs are the equivalent of program plus liquidating costs through 2001, plus the accrued liability remaining at the end of 2001.³ Excludes loans and guarantees by deposit insurance agencies and programs not included under credit reform, such as CCC farm supports. Defaulted guarantees which become loans receivable are accounted for in guaranteed loans.⁴ Net of borrowing from Federal sources, other GSEs, and federally guaranteed loans.⁵ The face value and Federal costs of Federal Family Education Loans in Sallie Mae's portfolio are included in that account above.

Deposit insurance costs declined sharply, following the closure of so many insolvent banks and thrifts in the 1980s. Depository institutions, which tend to borrow short and lend longer-term, benefited substantially from the decline in interest rates and the steepening yield curve of the early 1990s, as well as from the low unemployment, strong incomes and profits, and continued

low interest rates of the past year. Banks especially had record earnings in 1993-95, built strong capital positions, and restored the reserves of the Bank Insurance Fund (BIF). The banks' strong capital cushion will help to buffer BIF against the effects of interest rate risk, increasingly complex financial instruments, and

more intense competition as regulatory, geographic, and functional barriers fall.

Student loan costs, both direct and guaranteed, are also reduced by declining interest rates, in particular the expectation that rates will continue down as the Federal budget moves toward balance. The direct loan program gains from lower borrowing costs; the guaranteed loan program gains from lower interest supplements while students are in school or when interest rates are high. Default rates have also been reduced, primarily by excluding formerly high-default schools and ineligible students from the program.

Farm Service Agency direct loans, some of which have very low interest rates by statute, also have lower interest costs when interest rates come down. These portfolios also benefited from the recovery in farm income and land values and in rural economies.

The **Small Business Administration**, in an effort to ensure the continued availability of credit to small businesses, has adopted a policy of reducing, even eliminating, subsidies for its primary loan programs. Larger fee income, increased risk-sharing with guaranteed lenders, and a proposed shift of the Section 504 Community Development Company program to a direct loan program, all reduce the subsidies paid by SBA.

Eximbank, too, has adopted a policy of reducing or eliminating subsidies. Higher fees, collateralization, escrow accounts, and asset-based financing are some of the methods used.

For one program, **FHA multi-family** loan guarantees, the current estimate of future costs is higher than previous estimates. Before now, the cost of this program did not include the effect of the Federal rental subsidies, which many of these properties receive, on their financial condition. Current law does not allow for indefinite continuation of these subsidies at their current levels. Reductions in rental subsidies would create some mortgage defaults, resulting in payments from the FHA insurance fund. These costs, along with proposals to minimize them, have been reflected for the first time in the estimate of future costs.

Pension guarantee cost estimates amount to \$30–60 billion this year, as a result of refinements in the model, and the effect of lower interest rates on the value of future pension benefits. However, good economic conditions with high profits reduced sponsor bankruptcies last year. Rising stock markets and increased funding under the Retirement Protection Act of 1994 bolstered pension plans. And the Pension Benefit Guaranty Corporation negotiated 30 major settlements under their Early Warning Program that provided \$13 billion in new contributions from companies.

In sum, the present value of future costs of Federal credit and insurance programs is now estimated to total \$94 billion to \$181 billion—a substantial improvement from the \$120 billion to \$225 billion estimated last year.

II. Developing A Performance Measurement Framework

It is not enough to have a good rationale for a Federal program and to know its cost; it is also necessary to assess whether it is achieving its intended results. The Government Performance and Results Act (GPRA) is encouraging such assessments by requiring agencies to define their missions and long-term objectives using strategic plans, to set annual performance goals, and to measure actual performance against those goals.

Credit program managers, who have long worked together on credit reform and other matters, established a Performance Measures Task Force under the Federal Credit Policy Working Group to develop a common framework of such measures. These are to be used in their agencies' annual performance plans under GPRA and their budget requests to explain what they intend to accomplish. The same measures are to be shown in their annual performance reports and Chief Financial Officer's Accountability Reports to explain actual results.

The Task Force believes that a common core of indicators would be useful to program managers, the Executive Branch, the Congress, and the public—helping them to understand and compare credit programs. The group sought to identify the most appropriate measures, whether or not data was currently collected on them by some or all agencies. They expect that agencies will supplement the core measures with program-spe-

cific measures whenever they are useful to assess their programs.

The common framework has four main categories of indicators: inputs (the resources used), outputs (the goods or services produced), outcomes and net impacts (the gross and net effects on society). The specific measures below reflect discussion so far, but are still subject to modification.

Inputs. The group chose three common inputs: program objectives and performance goals (planning inputs), subsidy costs, and administrative costs (both resource inputs).

- When GPRA is fully implemented, one input would be the program's objectives from the agency strategic plan, and the program's performance goals from the agency's annual performance plan. The objectives would be described in terms of outcomes and net impacts (the effects on society of the program's operations) or in cost-effectiveness terms (the best outcomes per dollar of resources). These objectives should be defined so as to relate to annual performance goals that are quantifiable and measurable.
- Subsidy cost outlays, cumulated over time for all of the program's loans or loan guarantees obligated in a given year (a cohort), would be the second input. The total subsidy cost for each co-

hort of loans or guarantees would be subdivided into three components: the initial subsidy cost, the cost of any loan modifications, and the cumulative amount of reestimates of the subsidy cost due to experience and new information, along with the interest thereon.

- Outlays for credit program administration would be the third input. This total would be subdivided into administrative expenses associated with: credit extension; direct loan servicing and guaranteed loan monitoring; the cost of collecting delinquent loans and other write-off or close-out costs; and other administrative costs such as policymaking or systems development.

Outputs. The most obvious output of Federal credit programs is the number and value of direct loans originated or loans guaranteed. This is the “product” that credit programs produce and provide to the public. But volume alone does not achieve the objectives of Federal credit programs; indeed, large volume or market share may be a sign of excessive competition with private lenders. Loans must have certain characteristics in order to achieve the desired outcomes; these characteristics are part of the desired output.

- Federal credit is intended for borrowers who would not otherwise have access to credit, or is extended for longer periods or at lower cost to the borrower in order to assist certain target groups or encourage certain activities. Therefore, output measures would include an estimate of the percent of loans or guarantees originated going to borrowers who would otherwise not have access to private credit; and the percent of loans or guarantees originated going to specific target groups or for specific purposes (e.g., countervailing foreign subsidies).
- Within the limits imposed by extending credit to higher-risk borrowers or for higher-risk purposes, finding ways to assist borrowers to repay loans is usually associated with achievement of program objectives. Home ownership requires mortgage repayment. Remaining in business with a good credit rating requires repayment of farm, small business, and export loans. Education that enhances income is associated with repayment of student loans. And loan repayment is inherent in program cost-effectiveness. Therefore, output measures would include the percent of loans or guarantees that are current (i.e., performing and not delinquent), compared with the percent expected to be current at this point in the repayment cycle. If maintaining currency is enhanced by particular characteristics of loan structure (e.g., initial borrower equity), of loan origination (e.g., verifying borrower financial status), of loan servicing (e.g., prompt counseling), or of guarantee conditions (e.g., lender risk-sharing), the percent of loans fitting these categories contribute to output.
- Since defaults will occur, another aspect of output would be recoveries on defaulted loans (e.g.,

through collections, or sales of loans or collateral) as a percent of unpaid principal and interest.

- Overall, programs would like to “produce” satisfied customers, which could be measured by surveying the percent of borrowers who are pleased with the timeliness and quality of credit program service.
- Finally, program managers are asked to produce high quality subsidy estimates, as measured by the cumulative amount of reestimated cost as a percent of the original subsidy cost (and any loan modification cost). It is also important to know the extent to which reestimates were due to changes in interest rates, defaults, or other factors.

Outcomes. Outcomes of Federal credit programs are the effects on society that the program achieves—both its objectives or intended outcomes and its unintended effects. The desired outcomes of credit programs are more diverse than their inputs and outputs. However, programs providing similar types of credit may seek common outcomes, and there may be parallels among the outcomes sought by different types of programs. Below are some outcomes chosen by credit programs, clustered to show their common elements.

- Reaching under-served populations and neighborhoods might be measured by indicators such as: the number of low-income or minority people who completed education, or acquired and still own homes or businesses with help from the program; or the number of homes, businesses, or community facilities financed in under-served urban or rural neighborhoods.
- Encouraging start-up of new activities might be measured as: the number of beginning farmers, new businesses, new exporters, and first-time homebuyers financed by the program; or the amount of private financing leveraged in support of new activities.
- Supporting investment important to the economy might use indicators such as: the amount and quality of education financed; business investment financed; amount of exports financed; and amount and quality of low-income housing and community facilities financed.
- Sustained economic improvement achieved could be measured by: gross jobs directly or indirectly created due to this credit; number of placements in jobs for which credit-financed education prepared students; higher income levels attained; solid financial condition achieved; and communities developed with facilities up to standard.
- Programs can also have unfavorable consequences. For example, borrowers may accumulate excessive debt burden or their credit rating may be reduced. Unviable or low-return activities may be financed. Private financing for these borrowers or for projects with higher returns may be crowded out. Outcome goals could include minimizing such unfavorable consequences.

- For some programs, the outcomes occur long after credit is extended. Student loans, for example, may raise borrowers' lifetime incomes and quality of life. New farmers or small businesses may take many years to become financially viable. If such is the case, programs may want to identify an intermediate outcome or milestone along the way toward achievement of the ultimate desired outcome. For student loans, this might be the percent of low income students who gain access to post-secondary education. For mortgages, it might be the percent reaching a specified proportion of borrower equity. For businesses, it might be the percent still in business. A general intermediate outcome might be the percent of borrowers who fully repay their loans.

Net Impacts. Impacts assess the net effect of the program compared with what would have occurred in the absence of the program. Some program outcomes would be achieved in the absence of the program; for example, Federal credit sometimes substitutes for private credit rather than supplementing it. The Task Force thought that "additionality," or supplementation

of private credit, was an important measure of program success.

Impacts measure the net increase in any outcome due to the operation of the credit program. Instead of the number of small businesses financed, it would measure the number net of any substitution for private credit. Other examples would be the net increase in exports, in jobs, or in homeownership due to the existence of Federal credit programs. Such effects are very difficult to estimate. They usually require a program evaluation or economic study. To produce such estimates every year is unlikely to be cost-beneficial. But the group thought that program impacts should be assessed from time to time. The most recent assessment should be reported annually with appropriate commentary on changes since the last assessment and a note on the timing of the next scheduled assessment.

Agencies are far from collecting all of the performance measures included in this framework, but they are making progress toward it. Some of the performance measures already being monitored by particular programs are discussed in relation to those programs in the sections below on agricultural credit, business credit, education credit, and housing credit.

III. Financing the Nation's Agriculture and Rural Areas

The Nation's agricultural sector and its lenders are now on much firmer ground, following recovery from the financial crisis in the mid-1980's. Farm income has improved, helping borrowers to pay down debt and lenders to augment their capital. Land prices have stabilized and are now rising slowly. Both real interest rates and inflationary expectations are lower. And management in both farming and farm finance have improved.

Another sign of the increasing health of agricultural finance is the greater share of credit now provided by the private sector, particularly commercial banks. In the decade from 1984 to 1994, commercial banks' share of all agricultural finance increased from 24 percent to 39 percent, while the share of insurance companies and individuals and others stayed about constant at 6 percent and 24–22 percent respectively. As the agriculture sector recovered, the market share declined for the Farm Credit System from 33 percent to 24 percent, and the consolidated Farm Service Agency (successor to the Farmers' Home Administration) from 12 percent to 8 percent.

The Farm Credit System

Despite its declining market share, the recovery in agriculture has returned the Farm Credit System (FCS)—the first Government-sponsored enterprise—to financial health. After losses in 1985–87, the System has reported positive net income every year, reaching a record \$1.2 billion in 1993. Nonperforming assets declined from \$14.3 billion in 1987 to \$1.6 billion in 1994

as a result of both repayments and write-offs. An increase in accruing loans and a decline in cost of funds have widened the FCS's net interest margin from less than one percent in 1987 to more than three percent in 1993–94.

Improved asset conditions and income enabled FCS to report record capital levels in 1994 of \$8.8 billion, or more than 13 percent of assets. Two-thirds of this capital (\$5.7 billion) was surplus, rather than the borrowers' equity in these cooperatives, up from 42 percent in 1982. Included in this capital are investments set aside to repay about \$600 million of the \$1.3 billion of Federal assistance provided through the Financial Assistance Corporation (FAC) due beginning in 2003, and the System has adopted an annual repayment mechanism to cover the remainder.

Moreover, the improvement in the System's financial condition is widespread. The Farm Credit Administration, FCS's Federal regulator, rates each of the System's institutions for capital, asset quality, management, earnings, and liquidity (CAMEL). At the end of 1990, 94 institutions carried the best "CAMEL" ratings of "1" or "2", and 40 were rated in the troubled range of "4" or "5". By 1995, in contrast, 225 institutions were given the top two ratings and no institutions were in the troubled categories. Similarly, enforcement actions to correct illegal or unsafe operations applied to 77 institutions with 80 percent of FCS's assets in 1991 but to only 12 institutions with 11 percent of FCS's assets in 1995.

GOVERNMENT-SPONSORED ENTERPRISES

Government-sponsored enterprises (GSEs)—the most rapidly growing providers of credit assistance—are highlighted in the sections below. GSEs are privately owned financial institutions, whose policies and operations are determined by their boards of directors, a majority of which are elected by private owners. However, they were chartered by the Federal Government to facilitate the flow of funds into agriculture, higher education, and housing. Each was established because wholly private financial institutions were thought to be incapable of providing an adequate supply of loanable funds at all times and in all regions.

Federal sponsorship gives the GSEs a borrowing cost advantage that allows them to provide credit more cheaply than other private financial institutions. Most GSEs also enjoy special legal benefits under Federal law. Typically, these benefits include an ability to borrow from the Treasury, at Treasury discretion, in amounts ranging up to \$4 billion; exemption of their securities from Securities and Exchange Commission (SEC) registration; exemption of their corporate earnings from State and local income taxation; and eligibility of their securities to collateralize public deposits and be held in unlimited amount by most banks and thrifts. With these advantages, GSEs have grown to enjoy considerable economies of scale. Private ownership and control distinguish the GSEs from Federal agencies that make and guarantee loans to similar borrowers; their Federal sponsorship and special legal benefits distinguish them from other privately owned financial institutions that operate in the same credit markets but have very different, if any, ties to the Federal Government.

There are seven GSEs today: the Farm Credit System, the Federal Agricultural Mortgage Corporation (Farmer Mac), the Student Loan Marketing Association (Sallie Mae), the College Construction Loan Insurance Association (Connie Lee), the Federal National Mortgage Association (Fannie Mae), the Federal Home Loan Mortgage Corporation (Freddie Mac), and the Federal Home Loan Banks (FHLBanks). These institutions (except for Connie Lee, an insurer) raise funds in the securities markets and use the money to lend to individuals or businesses or to purchase loans originated by private lenders. The GSEs have fostered the development of credit markets by creating new loan products and services, standardizing the terms of loans and credit market transactions, and providing liquidity to lenders.

Costs and Benefits of Federal Sponsorship

Federal sponsorship imposes limited costs on and conveys substantial benefits to each GSE. Costs are imposed by the restrictions on the types of loans that each may make or purchase, which limit credit risk diversification, and the expectation that it serve markets in all regions of the country at all times. The GSEs also bear costs associated with statutory requirements to achieve specific policy objectives such as targeting a proportion of their lending to borrowers of above-average credit risk.

The costs of Government sponsorship are far outweighed, however, by the benefits. The credit market's perception that each GSE's obligations are implicitly backed by the Federal Government enables each GSE to borrow at near-Treasury rates. Investors infer an implicit Federal guarantee from their Federal sponsorship and public purposes, the strong support for their missions, the legal benefits enjoyed by the enterprises, and the huge volume of their outstanding securities.

This market perception has two important consequences for public policy. First, the GSEs are not subject to market discipline to the same degree as wholly private financial institutions and, therefore, can operate with much lower levels of capital. If a GSE incurred substantial losses or became insolvent, the Government would have the difficult choice of arranging for it to be recapitalized, perhaps at taxpayers' expense, or allowing it to increase its risk or even default on its obligations, which would prevent its public purposes from being accomplished, harm the value of all GSE securities, and throw financial markets into turmoil. To avoid such a situation, the Government must ensure that each GSE is well managed and adequately capitalized.

Second, the borrowing cost advantages arising from the perception of an implicit guarantee convey economic subsidies to each GSE. The greater an enterprise's overall risk exposure relative to its capital, the greater the economic subsidy. A GSE's overall risk depends on its exposure to credit risk, interest rate risk, management and operational risk, and business risk (the risk of unexpected changes in its business environment). The economic subsidies received by the GSEs affect the allocation of society's resources, but are neither recorded in the President's Budget nor controlled through the Federal budget process. Recently, the Shadow Financial Regulatory Committee, a group of financial experts, suggested that Federal subsidies to GSEs should be recorded in the Federal budget in a manner similar to credit subsidies.

The Federal Government relies on regulation and oversight to control the GSEs' activities. Safety and soundness regulation of the enterprises uses on-site examinations and risk-based capital requirements to manage the Government's exposure to risk and the economic subsidy conveyed by investors who perceive implied Federal backing. Programmatic regulation assures that the GSEs appropriately target their activities and the subsidies they receive.

The Changing Role of FCS. The System's original mission was to serve as a market force to ensure an adequate supply of competitively priced credit to the benefit of farmers. Loans to farmers and other eligible borrowers still comprise 74 percent of the System's portfolio. Loans to producers surged through the early 1980s, fell back, and then slowly recovered, with lending secured by farm mortgages stagnant in volume since 1990, but farm operating credit growing.

Since its origination, FCS's authorities have been broadened, introducing 26 new types of lending. In particular, the System's authority to lend to farmer cooperatives has generated a stable or growing volume for much of the past 20 years. These loans, which fi-

nance processing, exports, and rural utilities, comprised 26 percent of the FCS's portfolio in 1995. Although it is little used, FCS also has authority to lend to other agricultural lenders.

Reducing Recent Risks. The FCS is exposed to concentration risk, from which it suffered in the 1980s. Because its mission is to lend to agriculture, it cannot diversify across industries or products other than loans. Direct lenders in FCS are also geographically limited, often to areas dependent on one or a few commodities. In 1994, 32 percent of the direct lending institutions had portfolio concentrations in Federal farm program

commodities of 50 percent or more, and 55 percent had concentrations over 30 percent.

FCS has, however, succeeded in reducing its overall credit risk, measured by the proportion of loans which are nonperforming. At the end of 1995, nonperforming loans were 2.4 percent of all System loans, down from 14 percent in 1990. Measured by a similar concept, the figures for commercial banks were 0.9 percent, down from 2.8 percent in 1992.

In the 1970s, the FCS priced its loans based on a blended cost of debt, primarily long-term, fixed-rate debt. As interest rates rose in the late-1970s and early 1980s, this average cost pricing led to substantially below-market loan rates to borrowers—and rapid increases in loan volume, financed by substantial high-cost, long-term, fixed-rate borrowing. When interest rates began to fall in the mid-1980s, the average cost of System debt made its loan rates over-market, and loan volume fell sharply. Since then, the FCS has retired all of its high-coupon long-term debt, moved to marginal cost loan pricing, and adopted management practices designed to reduce its interest rate risk.

Operating risk is also being reduced. Substantial wholesale and retail level consolidation has occurred in the structure of the FCS, as authorized by the Agricultural Credit Act of 1987. But many of the effects of the massive restructuring have yet to be realized. Aggregate staff levels have only begun to decline, and the same is true for noninterest operating expenses. The operating expense rate declined from 1.49 percent of total loans in 1994 to 1.44 percent in 1995.

The 1987 Act also established the FCS Insurance Corporation to insure timely payment of interest and principal on FCS obligations. This supplemented the System's capital, the Federal Credit Administration's enforcement authorities, and the joint and several liability of all System banks for FCS obligations. The Corporation collects insurance premiums from the System banks, and earns investment income on them, providing funds to fulfill its function, which now amount to \$884 million.

Meeting Future Challenges. The Farm Credit System is stronger now than it has been in years. But it is exposed to future risks arising from changes in government policies toward agriculture, structural changes in the agricultural and banking sectors, strong competition from traditional and nontraditional loan and service providers, and uncertainties about export and domestic agricultural markets.

- Changes in U.S. farm policy appear imminent. While the exact nature of the changes is uncertain, they could result in reduced price protection and more volatile farm incomes. In turn, credit risk could increase for farm lenders.
- Both agriculture and banking are becoming more concentrated and more sophisticated. In banking, consolidation is driven by adoption of computer/communications technology and by the breakup of statutory regimes that have provided geographic and product line separations. In agri-

culture, vertical integration in the food system, and the growth of input suppliers and other non-traditional sources as creditors have tied farms to nonfarm businesses.

- FCS's farm loan growth has been very slow in recent years, given slow growth in agricultural credit generally and incursions by commercial banks and input suppliers. This has made covering operating expenses difficult. With an aging farm ownership population, substantial land turnover is expected in the next 10–20 years, but it is unclear how much FCS financing would be involved, because many currently mortgage-free farms might not be profitable if incumbered with a mortgage.

These and other uncertainties will challenge the Farm Credit System to adapt in order to retain its current financial strength.

Farmer Mac

The Federal Agricultural Mortgage Corporation (Farmer Mac), another GSE, is a federally chartered, privately owned corporation established by the Agricultural Credit Act of 1987. Its goal is to create and oversee a secondary market for, and to guarantee securities based on, agricultural real estate loans. The secondary market is intended to increase the availability of long term credit to farmers and ranchers at stable interest rates, and improve the availability of credit for rural housing.

Since the 1987 Act, Farmer Mac has been authorized to issue its own debt securities, and to operate a secondary market in agricultural loans guaranteed by the Farmers Home Administration ("Farmer Mac II"). The Farm Credit System Reform Act of 1996 further expanded its powers, transforming Farmer Mac from just a guarantor of securities formed from loan pools into a direct purchaser of mortgages in order to form loan pools to securitize.

The 1996 Act was passed in response to a steady erosion of Farmer Mac's capital base. Revenues from services as a guarantor, and a pooler under Farmer Mac II, did not meet expectations and showed no prospect of improvement. The new powers increase banks' incentives to participate in Farmer Mac and allow Farmer Mac to serve as pooler.

However, these powers also subject the Corporation to more credit risk. Prior to the 1996 Act, Farmer Mac had little risk from defaults in the loan pools since a 10 percent subordinated interest in loans pooled was required to be held by originators or other entities outside the pool. As a direct purchaser of loans with no required subordination, Farmer Mac will be exposed to such losses, and must estimate them accurately for fee setting and for determining the appropriate level of capital reserves. The 1996 Act gave Farmer Mac three additional years for reaching its minimum and critical capital requirements, and two years to raise an additional \$25 million in capital.

The Office of Secondary Market Oversight (OSMO) in the Farm Credit Administration is responsible for the regulation of Farmer Mac. It is required to establish a stress test to determine the amount of regulatory capital Farmer Mac will be required to hold. The goal is to allow Farmer Mac to survive worst-case conditions of credit risk and interest rate risk, using historical conditions to define the worst cases.

In addition to expanding the powers of Farmer Mac to allow it to perform all of the functions of a mortgage purchaser, the 1996 Act removed the requirement that originating lenders and/or poolers maintain a 10 percent subordinated interest in pooled loans, and removed diversification requirements. These provisions raise the possibility of losses, but their precise effects can not yet be determined. An important curb on loss potential is the continuing requirement of a 75 percent loan-to-value ratio for collateral and maintenance of challenging creditworthiness standards for eligible borrowers. Individuals or businesses are less likely to default if they have a significant investment in the collateral and/or would surrender a good credit history as part of a default process. The Congress has directed the Farm Credit Administration and the Treasury to periodically evaluate Farmer Mac's performance.

The Farm Service Agency

Within the Department of Agriculture, farm operating, ownership, and emergency loans are now made by the Farm Service Agency (FSA). FSA direct and guaranteed operating loans provide credit for annual production expenses and purchases of livestock, machinery, and equipment. Direct and guaranteed farm ownership loans assist producers in acquiring their farming or ranching operations. In 1997, \$546 million in direct loans are authorized, along with \$2.7 billion in guaranteed loans. Originally intended to be a "temporary lender of last resort", the programs have become a continual source of subsidized credit.

A permissive emergency loan program enacted in 1975, a series of natural disasters, and the farm financial crisis of the mid-1980s led to FSA holding a large portfolio of nonperforming loans. The Agriculture Credit Act of 1987 provided for write-down and write-off of these loans and generous "borrower rights." Delinquent borrowers are eligible for interest rate reductions and moratoriums on all loan payments for up to five years. The statute mandates that additional loans must be made to borrowers delinquent on previous loans. As a result, between 1978 and 1994, loan losses amounted to nearly \$16 billion, of which 66 percent were on emergency and economic emergency loans.

New loan originations are not expected to perform as poorly; nonetheless, high default and low recovery rates are still expected. In part, this results from the program's inherent characteristics. As a condition of eligibility, direct loan borrowers must have been denied private credit at reasonable rates and terms, or they must be beginning farmers. Poor performance is also expected because of overly restrictive requirements in

the 1987 Act. For example, it may take five years for USDA to dispose of property taken into inventory. During this time, USDA must maintain the property if it is not leased.

Guaranteed farm loans have not experienced the same relative losses as direct loans. Guaranteed loans are made to more creditworthy borrowers who have access to private credit markets. Because the private originators must retain 10 percent of the risk, greater care is exercised in examining borrower repayment ability.

Expected Reforms in the 1995 Farm Bill. The Administration has proposed changes to the farm loan programs to reduce loan loss potential while assuring that socially disadvantaged groups and beginning farmers have access to credit. Proposals include denying program eligibility to borrowers whose previous loans resulted in buy-out or other debt settlement; removing the requirement that production loans be made to delinquent borrowers; and removing or reducing time frames for notification, acceptance, and completion of actions on delinquent loans. The Senate-passed Farm Bill includes most of the Administration proposals. In addition, it would speed up the disposition of acquired assets, tighten eligibility requirements for beginning farmers, and remove refinancing existing debt as a direct loan purpose. These changes would limit loan losses and reduce Federal risk.

Rural Electric and Telephone Programs

Rural electric and telephone borrowers range from multi-billion dollar cooperatives to local telephone companies with as little as one million dollars invested. The intent of the program was to bring electric and telephone service to under-served rural areas. Today, over 99 percent of rural households have electrical service and 97 percent have telephone service.

The Federal risk associated with the over \$50 billion loan portfolio in electric and telephone loans historically has been relatively small. Aside from several large defaults which were primarily a result of nuclear power construction loans that failed, expected default rates are low. However, both industries are moving into a more competitive environment. Meanwhile, Federal financing has decreased since program reforms were enacted in 1993. This combination of greater competition and less finance will likely increase the Federal loss exposure. A 1995 study by Moody's Investors Service concluded that the credit quality of electric cooperatives will likely deteriorate over the next 5 to 10 years.

Rural Business-Cooperative Service

USDA's assistance for rural businesses and cooperatives is distributed through the Rural Business and Cooperative Service. USDA provides an array of grant, direct loan and loan guarantee programs that assist the creation and expansion of businesses in rural areas and provide assistance for small infrastructure improvements. The programs provide assistance to small and large businesses in rural areas with amounts ranging

from small grants up to \$10 million loan guarantees. The loan and loan guarantee programs have low default rates.

Changes in the 1995 Farm Bill. The 1997 Budget and the Administration's Farm Bill proposals would combine fourteen rural development programs into one more flexible program called the Rural Performance Partnership Program (RPPP). In addition to USDA's business assistance programs, USDA's rural water and wastewater grants and loans, loans for essential community facilities, and loans for new construction of rural rental housing and the corresponding rental as-

sistance would be allocated through the new program. USDA's Rural Economic and Community Development State Directors would have authority to transfer up to 25 percent of the funding between these programs. These State Directors would work with State and local governments, other community-based organizations, and the State Rural Development Councils—whose members include State, local, and Tribal governments, and private sector representatives—to direct funds to each State's highest rural economic development priorities. Performance measures and incentives are included in the RPPP proposal. The Senate included a very similar program in its Farm Bill.

IV. Financing Small Business and Exports

The Small Business Administration

The Small Business Administration, the Federal Government's primary small business lender, provides more than 80 percent of its funds through the Section 7(a) General Business Loan Guarantee program. Other SBA programs provide direct loans to businesses and homeowners who have been victims of natural disasters, guarantee loans for venture capitalists and for long-term project-based lending, and provide both direct loans and loan guarantees to microlenders. In recent years, SBA has coped with rapidly growing loan demand, proposed various program reforms to reduce subsidy costs, undertaken a major effort to analyze historical loan performance data, and developed program performance measures.

A Rapidly Growing Loan Portfolio. The SBA's loan portfolio has expanded rapidly in recent years.

- Through the 7(a) loan program in 1991, SBA guaranteed approximately 9,000 loans totaling about \$4 billion. By 1995, those figures had risen to approximately 56,000 loans totaling about \$8 billion, and the loan volume could have been even higher if additional lending authority had been available.
- The Section 504 Community Development Company loan guarantee program, SBA's second largest loan program, has also grown rapidly. In 1991, the SBA provided about 1,400 financings totaling nearly \$400 million. By 1995, those figures had increased to about 4,500 financings for \$1.5 billion.

And a Declining Staff. During this period, the staff working on SBA's credit programs declined over 20 percent. Given that most of these loans have 10 to 20 year maturities where the bulk of defaults occur in years 3–7, SBA's loan servicing and liquidation workload is likely to increase rapidly in coming years, at a time when Federal discretionary resources are almost certain to decline. While improvements in information technology and other management efficiencies have allowed SBA to maintain an expanding portfolio with declining administrative resources thus far, this trend

cannot continue indefinitely. A key goal for SBA and other credit agencies in the coming years will be to ensure their ongoing ability to maintain quality up-front credit review and underwriting, loan servicing, and liquidation procedures in the face of declining Federal discretionary funding.

Reduced Subsidies. Based on SBA's Reinventing Government proposals announced in April 1995, the Congress enacted new fees and other program reforms to reduce the subsidy rates for the 7(a) and 504 programs in October 1995. For the 7(a) program, the guarantee percentage for all loans was lowered to 75 percent, except for those under \$100,000 which was lowered to 80 percent. The up-front guarantee fee was increased and an annual 50 basis point fee was established in lieu of the existing 40 basis point fee on loans sold into the secondary market. Combined, these reforms lowered the 1996 7(a) subsidy rate from 2.74 percent to 1.06 percent. A new annual fee of one-eighth of one percent was established for the 504 program, lowering its 1996 subsidy rate to zero. These reforms furthered SBA's efforts to ensure that its credit subsidy funds go to borrowers least able to obtain private financing and that among these eligible borrowers, the most economically viable business proposals are funded. The higher guarantee percentage on smaller loans, as well as SBA's LowDoc program, serve as incentives to lenders to make more small loans, which are more costly for lenders to make.

Historical Performance Study. During 1995, SBA undertook a comprehensive study of its loan records dating back to 1982, collecting time-series data from multiple sources. For the first time, SBA is now able to quickly review data on historical loan performance, calculating performance by various loan characteristics such as size, maturity, guarantee percentage, lending institution, and type of business of the borrower. The availability of this data has greatly improved SBA's credit management capacities in key areas including accurate budgeting for credit programs; performance measurement; monitoring, managing and reducing program risk; and program design and effectiveness.

Subsidy Estimates and Reestimates. The most immediate use of the historical loan performance data has been for subsidy rate estimates and reestimates for this budget. Prior to this review, most of SBA's subsidy rates were based on a small-scale study conducted in 1991. The subsidy rate estimates included in the 1997 Budget for the 7(a) and 504 loan guarantee programs are based on 13 years of historical performance. To estimate the 1997 cohort subsidy rates, the historical cash flows were adjusted for program reforms enacted in October 1995 and anticipated characteristics of the 1997 cohort of loans (such as the expected weighted guarantee percentage and the volume of loans processed by preferred and certified lenders). For both 7(a) and 504, the data analysis showed that previous estimates of recoveries were substantially higher than SBA's actual recoveries. The previous estimate of defaults for the 504 program was also considerably lower than the historical default rate. In addition, the timing of defaults and recoveries differed from previous estimates. Consequently, the baseline (current services) subsidy rates for both of these programs was increased significantly.

It is worth noting that recent trends appear to demonstrate a gradual improvement in portfolio quality for the 7(a) program. These trends, as well as the program changes enacted in October 1995, were incorporated into the 1997 subsidy estimate. If these positive trends continue, the 7(a) subsidy will begin to decline next year. The Administration will continue to closely monitor loan performance and revise the subsidy estimates annually, as appropriate.

In addition, the Administration intends to continue econometric analysis, measuring the relative impact of various loan characteristics (e.g., loan size, maturity, guarantee percentage, lending institution, type of business of the borrower) on defaults and recoveries. This analysis will provide additional capacity for determining the effects of various program changes on ultimate loss expectations.

Performance Measures. The historical data review has also enhanced SBA's efforts to define and measure performance for its credit programs. Because financial performance and public policy objectives often conflict with one another, having good data available for analysis is especially valuable in helping policy officials make the difficult trade-offs often required between these two important criteria. For assessing financial performance, SBA has identified measures such as administrative and subsidy costs, percent of the portfolio that is current, and percent of defaults that are recovered. With its new data analysis capacities, SBA will be able to assess these factors at a more sophisticated level, determining for example, the impact the type of lending institution has on default and recovery rates. Relatedly, SBA's new data capacity will also enhance the agency's ability to manage program risk. For example, with easily accessible information on lenders' performance, SBA will be able to better monitor individual lenders' default and recovery statistics. This information will enable

SBA to identify and facilitate resolution of problem areas more quickly.

As a measure of the extent to which its programs are meeting their public policy objectives of providing loans to creditworthy borrowers who otherwise would not have access to capital, SBA monitors the portion of its loans which go to the most under-served segments of the small business market, such as minority and women business owners and small exporters. With its new data analysis capacities, SBA will be able to better target particular groups by identifying which types of loan products are best suited for specified borrowers. SBA will also be able to identify which lenders best reach these borrowers. SBA continues to seek additional measures of program impact. However, devising performance measures to assess the extent to which the agency's programs are supplementing, not acting as a substitute for, private capital is inherently challenging because of the difficulties in determining what would have taken place if the borrower had not received an SBA loan or guarantee.

Reducing Program Costs. Given the results of SBA's historical loan performance study, this budget proposes a number of changes to reduce the taxpayers' cost of SBA's largest loan programs. In order to keep the 504 subsidy rate at zero in 1997, the budget proposes to transform Section 504 from a 100 percent guarantee to a direct loan program. Under this proposal, SBA would lend directly to Certified Development Companies, rather than guaranteeing their debentures. This change would eliminate the cost of underwriters and other financial intermediaries. Importantly, these changes would not increase the cost of capital to the Certified Development Companies and would not increase the cost of borrowing to small businesses. This revision would lower the baseline 504 subsidy rate from 6.85 percent to zero. Second, the budget proposes to lower the taxpayers' cost of the Small Business Investment Company program by increasing fees for both participating securities and debenture loan programs. The establishment of an interest pass-through fee of one percent and an increase in the up-front funding fee from 2 percent to 3 percent for both programs would reduce subsidy costs significantly. Finally, the budget proposes raising the interest rate on disaster loans to the prevailing rate on Treasury securities of comparable maturity. Providing subsidized loans after a disaster discourages citizens from purchasing private disaster insurance.

Export and Investment Credit

Several Federal programs provide credit assistance to U.S. companies that export goods or services overseas or invest in overseas businesses or projects. In recent years, these programs have been characterized by two trends:

- A number of new programs have been created, or have been expanded in scope and size. As a result, there are a larger number of more flexible

options for Government credit assistance for potential U.S. exporters or overseas investors.

- Many of the export and investment credit programs have made efforts to lower subsidy rates, either across the board or for specific segments of their programs, by reducing the risk of their credits or increasing the fees they charge. Some of the newest programs aim for (or in one case are legislatively required to have) a subsidy rate of zero or less.

New or Expanded Programs. The U.S. Export-Import Bank and the Overseas Private Investment Corporation (OPIC), U.S. Government agencies that provide, respectively, export and investment credits, have both expanded the scope of their programs, and OPIC has greatly increased the overall size of its credit programs (from \$400 million in 1993 to \$1.9 billion in 1995). Eximbank has created a new project finance program and has significantly increased its use of non-sovereign credits (direct loans and loan guarantees that do not carry the full faith and credit of a foreign government), while OPIC has expanded its support of investment funds in developing countries. Both agencies have also significantly expanded their activities in East Central Europe and the states of the former Soviet Union.

In 1995, Title XI of the Merchant Marine Act was amended to allow the Maritime Administration to provide loan guarantees for the export of ships constructed in the United States. Similarly, the 1996 Defense Authorization Act created a loan guarantee program for financing the commercial export sales of U.S. defense articles and services. While both the Maritime Administration and the Department of Defense already administer credit programs, neither has been responsible for a commercial export credit program in the past.

Reducing Program Costs. In recent years, export and investment credit programs have made an effort to reduce their subsidy rates through program changes aimed at sharing or reducing risk. For example, Export-Import Bank has the explicit goal of making certain programs, such as project finance and short-term multi-buyer insurance, “zero subsidy” programs. Export and investment credit programs are increasingly using methods such as higher fees, collateralization, escrow accounts, and asset-based financing in order to reduce subsidy costs and expand direct loan and loan guarantee levels. In the case of the new defense export loan guarantee program, the legislation attempts to limit cost and increase the borrower’s share of risk by requiring that borrowers pay, through fees, all subsidy costs initially—though the legislation is written to allow appropriation of subsidies in the future—and prohibiting the financing of the exposure fees in the guaranteed loans.

Implications for Management. These trends raise a number of questions that cut across Federal export credit programs:

- As the number, size and diversity of Federal export and investment credit programs increase, comparison of the costs and benefits of these programs would ensure that the scarce resources are allocated to the most effective programs. Preliminary efforts to conduct this analysis have been started by the Federal Credit Policy Working Group and Trade Promotion Coordinating Committee (TPCC); however, this effort is hampered by the inherent difficulty in measuring the outcomes and net impacts of export credit programs. A number of performance measures have been identified, but further refinement in the quantification of these measures is required for an effective cost-benefit analysis.
- As programs propose changes to achieve lower subsidy rates, including zero or negative subsidies, this may indicate that similar activities could be done by the private sector for a profit, although the separate appropriation of administrative expenses means that the likely cost to the private sector is not entirely captured in the subsidy calculation. A recent study of the possibility of privatizing OPIC is likely to be followed by other analyses of effects of privatizing other export and investment credit programs. The OPIC study determined that any “privatization” of OPIC would likely require continued Government support as well as discounting, for sale purposes, the face value of OPIC’s existing portfolio. The increased diversity of the programs may also mean that specific aspects of programs, rather than the programs in their entirety, could be subject to privatization efforts. A key issue here is additionality, or the additional exports or foreign investment that a Government export or investment credit program makes possible. If a program moves towards zero or negative subsidy, and it is not possible to identify “failures” in the private sector’s ability to provide credit to competitive U.S. exporters or investors, then it is likely that the Government program in question could be privatized or eliminated without significant detrimental effects to exporters or investors.
- The rapid increase in the size of certain export and investment credit programs, the expansion of certain programs into particularly risky countries, and the recent creation of entirely new export credit programs could raise concerns regarding the administration of these programs, and, in particular, regarding the ability to conduct adequate due diligence and perform overall portfolio risk management. Agencies responsible for administering these programs will review and, where necessary, improve program administration, including upgrading information management systems, analyzing historical default data, and incorporating this information into subsidy calculations.

Spectrum Auction

The 1997 Budget includes a spectrum auction proposal that expands the Federal Communications Commission's successful spectrum auctions. The auction proposal allows for some of the winning bids to be paid in installment payments. This is substantively a direct loan and, as such, is covered by credit reform.

It is OMB's intent to score the installment payments associated with spectrum auctions under credit reform. However, the credit reform impacts of the spectrum auction were inadvertently omitted from the *Budget Appendix* and they have not been included in the tables in this chapter.

V. Education Credit

Student Loans

The Federal Government helps to finance student loans through two major programs: the Federal Family Education Loan (FFEL) program and the Federal Direct Student Loan (FDSL) program. Eligible institutions of higher education, including public and private 2-year and 4-year institutions as well as vocational training schools, may choose to participate in either program. Loans are available to students and their parents regardless of income. Borrowers with lower family incomes are eligible for higher interest subsidies.

Overall student loan volume is expected to increase by more than 60 percent over the next seven years. In 1996, total loan volume (excluding amounts for promissory notes that never result in loans) is expected to be \$30 billion, of which \$5 billion is for consolidation of existing loans and the remainder is for new loans. By 2003, total loan volume is expected to increase to \$47 billion, of which \$12 billion is for consolidations. The projected volume increase continues current trends, which have seen loan levels rise dramatically over the past 10 years. The principal causes of this increase—both to date and in the future—are steadily rising educational costs, higher loan limits, and a growing population of eligible borrowers.

The Federal Family Education Loan program provides loans to students and parents through a complex administrative structure involving over 7,000 lenders, 36 State and private guaranty agencies, 90 participants in the secondary market, and 7,300 participating schools. Under FFEL, banks loan private capital to students and parents, guaranty agencies insure the loans, and the Federal Government reinsures the loans against borrower default. In addition to paying for defaults, the Federal Government provides interest and administrative subsidies to banks and guaranty agencies.

The Federal Direct Student Loan program was authorized by the Student Loan Reform Act of 1993 to enable students and parents more easily to obtain and repay loans than was possible under the FFEL program. Under FDSL, the Federal Government provides loans directly to borrowers, thus eliminating the reinsurance and subsidization of private lenders. The program has several key advantages over the FFEL program:

- Borrowers may choose from a variety of repayment options, including income contingent repayment. This gives them a wider range of options

in pursuing public service careers and managing their finances.

- Application and repayment processes are streamlined for borrowers and schools, eliminating substantial paperwork and long lines at campus financial aid offices.
- Loan servicing and default collection is handled by contractors selected through competitive bidding processes. This ensures that the Federal Government obtains high quality administrative services at the lowest price possible. The FFEL program, by contrast, guarantees payments to all participating lenders and guaranty agencies based on fixed rates set by law, without regard to how well their services are performed.
- The simplified program structure is more manageable and significantly less vulnerable to fraud and abuse. In 1995, the Inspector General issued a clean audit opinion of the program, the first time a clean audit has ever been received by any of the Department's student loan programs.

Since the inception of the Federal Direct Student Loan program, lenders and guaranty agencies have made notable improvements in their own processes for delivering Federal student aid because of the competition with the Direct Loan program. The 1997 Budget assumes the continuation of current law: beginning July 1, 1996, any eligible institution may select which program will best meet the needs of their students.

The Administration is proposing legislative changes to both programs that would save \$4.4 billion over seven years through reductions in payments to lenders, guaranty agencies, secondary markets, and postsecondary institutions, as well as cut Federal administrative funds. This proposal establishes a competitive framework that requires all participants in the loan delivery process to operate with greater efficiency. The Budget does not propose curtailing benefits or increasing costs to borrowers.

The Federal Government has also played a limited role in helping to make capital available for higher education infrastructure. The Historically Black College and University Capital Financing Program insures bonds for construction and repair of facilities at these institutions. The Department of Education made its last direct loans for postsecondary facilities construction in 1993 under the College Housing and Academic Facilities Loans program. Financing for postsecondary facilities is available through alternative sources: municipal bonds, private loans, and fund-raising. Many schools

have access to the tax-exempt bond market and thus can borrow at favorable long-term interest rates. In addition, the College Construction Loan Insurance Association, a private corporation established by the Federal Government, and other municipal bond insurers enable many schools to obtain private capital.

Performance Measures. A key Department of Education objective is to promote access to postsecondary education for students at all income levels by removing financial barriers through an appropriate combination of grants, loans, and work-study funds. A variety of measures have been established to track how well the student loan programs contribute to this objective. These include the effect of loan availability (both subsidized and unsubsidized) on the percentage of low-income students who enroll in postsecondary education, the gap in college participation between high-performing students with low and high income, persistence in an educational program, and degree attainment.

Other measures of the student loan programs include the incidence of new defaults, recoveries on prior defaults, and implementation of management simplifications that better serve both borrowers and institutions. On these measures, the Department has demonstrated success. For example, the Federal Direct Student Loan program has been successfully implemented in over 1,300 schools. This has dramatically reduced paperwork, shortened processing times, and opened up a variety of alternative repayment options better suited to many students.

Default Estimates. Over the past few years students have tended to borrow more, stay in school longer, and default less. We expect these trends to continue.

The Department uses two different methods for determining default rates. The lifetime rates, which drive credit subsidy rates, are based primarily on recommendations of the Department of Education's independent auditor and reflect long-term historical rates for the number of defaults that occur over the life of a cohort of student loans. The Department also uses a short-term rate for determining program eligibility. This rate tracks the number of students who default over a two-year period following the year they are scheduled to enter repayment. The latest available data show that students scheduled to enter repayment in 1993 had a default rate in 1993–94 of 11.6 percent, a dramatic decline from the peak 22.4 percent rate three years earlier and even from the 19.6 percent average of 1988–1991. Schools with default rates above 25 percent for three consecutive years lose eligibility to participate in the student loan programs.

The Department has implemented a series of reforms to reduce default rates. These include:

- imposition of serious sanctions for default, including Federal income tax refund offset, wage garnishment, denial of further student aid, and loss of other forms of loans and credit;
- removal of schools with high default rates from participation in Federal loan programs. Since

1993, some 600 schools with high default rates have become ineligible; and

- screening of student aid applicants through the National Student Loan Data System to prevent ineligible students, and students who provide false information, from receiving Federal funds. In academic year 1995–96, this screening blocked issuance of \$230 million in loans to ineligible applicants.

Because the lifetime default rates used to calculate loan subsidies are based on long-term experience, they have remained relatively stable and do not reflect the dramatic recent declines in the short term rate.

Administrative Costs

Under the Federal Credit Reform Act, the Federal administrative costs of operating credit programs are funded on a cash basis and are not included in the subsidy. Hence, administrative costs for a given year reflect the amount needed to support loan management activities *in that year*, whether they are associated with new loans or loans made in prior years. Most of the guaranteed loan program is carried out by banks and guaranty agencies, and a portion of their administrative costs are covered by the subsidy. However, in the direct loan program, where most of the administrative activity is performed by Federal contractors, these costs are not included in the subsidy. For this reason, the subsidy calculation captures a greater share of administrative costs for guaranteed loans.

This past year, Congress attempted to “level the playing field” for these two programs by requiring that direct Federal administrative costs for the direct loan program be included in the FDSL subsidy. This approach was flawed, however, because it failed to make comparable changes in the guaranteed loan subsidy. Since Federal contractors perform many of the same activities (e.g., loan application processing, default collection) for both programs, adjustments would be needed in both subsidies. Until a sound methodology can be developed for incorporating administrative costs appropriately into both subsidy estimates, the Federal Credit Reform Act treatment should continue to be followed.

Sallie Mae

The Student Loan Marketing Association (Sallie Mae), a GSE, is a for-profit, share-holder owned corporation chartered by Congress in 1972. Its purpose is to expand funds available for student loans by providing liquidity to lenders participating in the Federal Family Education Loan program. Sallie Mae purchases insured student loans from eligible lenders and makes warehousing advances (loans to lenders secured by insured student loans, Government or agency securities, or other collateral). Sallie Mae has authority to provide additional services that are supportive of student credit needs, and to provide financing for academic facilities and equipment. Sallie Mae currently holds about one-third of all outstanding guaranteed student loans.

The Administration submitted legislation last year that would privatize Sallie Mae. Similar legislation developed by the Education Committees is under active consideration by the Congress.

Connie Lee

The College Construction Loan Insurance Association (Connie Lee), another GSE, was created by the Higher Education Amendments of 1986 to insure and reinsure the financing of postsecondary education facilities projects. The Department of Education helped provide initial financing of the corporation by purchasing, with appropriated funds, \$19 million of newly issued common stock. Subsequently, additional stock was issued and sold to institutional investors.

Legislation establishing Connie Lee restricts it to serving only postsecondary institutions with relatively low credit ratings. However, the Corporation has had to maintain a balanced portfolio in order to support its own credit rating, and to comply with State insurance laws. Because two States in which Connie Lee

operates require bond insurance companies to have 95 percent of their business in investment grade bonds, Connie Lee must meet this 95-percent standard in all jurisdictions in which it operates. These restrictions have prevented the corporation from insuring and reinsuring many of the lowest-rated schools it was established to serve.

Last year, the Administration proposed legislation to privatize Connie Lee by selling the Federal Government's stock and repealing the corporation's enabling legislation. This would enable Connie Lee to expand its insurance volume and thus make bond insurance available to more lower-rated schools. It would also free Connie Lee to enter other sectors, including elementary and secondary education, where insurance could make more readily available capital for badly needed infrastructure improvements. Both House and Senate passed legislation similar to the Administration's proposal last year. Enactment of legislation to privatize Connie Lee is likely this year.

VI. Financing Housing

Fannie Mae and Freddie Mac

Fannie Mae and Freddie Mac, the largest GSEs, dominate the secondary market for conventional mortgage loans. At year-end 1995, the two GSEs had financed \$1.46 trillion in mortgages and other assets. The institutions engage in two principal lines of business: they issue and guarantee mortgage-backed securities (MBS), and they hold debt-financed portfolios of mortgages, mortgage-related securities, and other assets. In the last decade, the activities of Fannie Mae and Freddie Mac have expanded greatly, and their role in the housing finance system has changed subtly. The growth in the GSEs' market share and the changes in their role have exposed them to greater risk and have made the task of managing their risks more complex.

Since the mid-1980s, the reduced role of thrift institutions and two major waves of mortgage refinancings enabled Fannie Mae and Freddie Mac to increase dramatically their penetration of the conventional mortgage market. Between 1991 and mid-year 1995, the two institutions purchased \$1.4 trillion in conventional single-family mortgages, an amount equal to 54 percent of the \$2.6 trillion in such loans originated during that period. The two GSEs' purchases of fixed-rate loans have comprised an even larger percentage of new originations of fixed-rate loans. As a result, the share of outstanding conventional single-family mortgage debt financed by Fannie Mae and Freddie Mac has increased from 18 percent at the end of 1985 to 42 percent at the end of 1994.

In recent years Fannie Mae and Freddie Mac have expanded their purchases of mortgages that are designed to be affordable to first-time homebuyers or households with low and moderate incomes. Both GSEs purchase mortgages with LTV ratios of 95 percent

where the borrower has made a downpayment of 3 percent, and Fannie Mae purchases loans with 97 percent LTV ratios. The Secretary of Housing and Urban Development (HUD) recently established new, higher goals for each category for 1996 through 1999. Each GSE will be required to achieve goals in three categories: housing for low- and moderate-income families; housing in central cities, rural areas, and other under-served areas; and specially targeted affordable housing. In order to achieve the goals, Fannie Mae and Freddie Mac may need to purchase some loans that pose greater than average credit risk or offer below-average returns.

Fannie Mae and Freddie Mac have also recently increased the proportion of mortgages that they retain on their balance sheets rather than securitize. Fannie Mae's retained mortgage portfolio grew from 26 percent of all mortgages financed at year-end 1991 to 33 percent of all mortgages at the end of 1995. During the same period, Freddie Mac's retained mortgage portfolio grew from less than 7 percent to over 19 percent of all mortgages financed. At the end of 1995, Fannie Mae's retained mortgage portfolio totaled over \$253 billion and Freddie Mac's was \$107 billion. Financing mortgages with debt is generally more profitable for the two GSEs than securitizing the loans, but it exposes them to more interest rate risk. Hence, the rapid growth in the two Enterprises' retained portfolios has increased the importance of good interest rate risk management.

In the last two years, Fannie Mae and Freddie Mac have offered more software and on-line services for lease by mortgage lenders. The most prominent of the new offerings are the GSEs' automated underwriting systems (AUS), which became commercially available in 1994. Lenders can use each AUS to obtain underwriting evaluations of and commitments to purchase

single-family mortgages, to order credit reports from credit reporting companies, and, in the case of Freddie Mac's system, to order appraisals and other less-intensive assessments of the value of properties pledged as loan collateral. The GSEs are marketing these new products and services in an effort to increase their profitability by increasing their respective market shares, improving the credit quality of the loans they buy, and earning additional fee income. The initiatives pose new management and operational risks, however.

Monitoring Fannie's and Freddie's Risk

Fannie Mae and Freddie Mac are highly profitable institutions. Despite a 15 percent decline in the volume of single-family mortgage originations in 1995, both Enterprises posted record profits. Fannie Mae earned net income of \$2.14 billion in 1995, up slightly from \$2.13 billion earned in 1994. Freddie Mac recorded net income of \$1.09 billion in 1995, an 11 percent increase over 1994 earnings of \$983 million.

Despite large cyclical changes in interest rates and in the volume of conventional mortgage originations, in each year since 1986, Fannie Mae and Freddie Mac have achieved returns on average common equity in excess of 20 percent—far more than the average returns on equity of federally insured commercial banks or savings institutions. In recent years the GSEs have used their high incomes to increase their equity as a share of on-balance sheet assets and off-balance sheet MBS.

Federal sponsorship of Fannie Mae and Freddie Mac does not expose the government to any immediate danger of loss. However, over the long term the government is exposed to material risk that could become quite large if either GSE was poorly managed or became undercapitalized. Current law provides for the government to manage its exposure by conducting on-site examinations and imposing risk-based capital requirements. Risk-based user fees are another potential risk management tool that would compensate for a portion of the economic subsidy that Federal sponsorship conveys to the GSEs. On-site examinations and risk-based capital requirements must be implemented in a sophisticated way that takes into account the rapid evolution of the mortgage industry and the activities of Fannie Mae and Freddie Mac. Three ways in which their operations and risk exposure are evolving illustrate this point.

- The reliance of Freddie Mac's automated underwriting system on a customized application scoring model and the commitment by both GSEs to using credit scoring in the underwriting and quality control processes represent watershed changes in credit risk management practices, altering each institution's credit risk exposure, profitability, and approach to pricing new business.
- The recently mandated increase in the two GSEs' goals for purchases of mortgages that finance affordable housing, and the higher delinquency rates on such loans, highlights the importance of managing this risk.

- As Fannie Mae and Freddie Mac rapidly grow their portfolios, they are increasingly investing in mortgage derivatives, using non-mortgage derivatives to manage their interest rate risk, and using nondollar borrowings to lower their borrowing costs. These activities increase their exposure to counterparty, currency, and other risks and make managing the risks in their portfolios more complex.

Risk-based capital requirements complement on-site examinations and off-site monitoring by protecting the government from increases in its risk exposure due to changes in the credit risk of conventional mortgages, in interest rates, or in the GSEs' business strategies. The Federal Housing Enterprises Safety and Soundness Act of 1992 requires the Office of Federal Housing Enterprise Oversight (OFHEO) to use a stress test model to promulgate risk-based capital requirements for Fannie Mae and Freddie Mac. A sophisticated stress test model can reflect the risks of each GSE's operations and produce capital requirements that are dynamic and forward-looking. This will allow the standards to reflect changes over time in the risk exposure and risk management techniques of Fannie Mae and Freddie Mac.

Risk-based capital requirements that accurately reflect the risk of Fannie Mae and Freddie Mac may also limit the distortion of competitive outcomes created by the economic subsidy conveyed by government sponsorship. The share of mortgage debt financed by Fannie Mae and Freddie Mac is likely to increase in the future as new technologies reduce the costs of originating conventional mortgages and affordable lending programs and credit scoring qualify more borrowers for conventional loans.

Federal Home Loan Bank System

In the six years since the enactment of the Financial Institutions Reform, Recovery and Enforcement Act (FIRREA) of 1989, the Federal Home Loan Bank System (FHLBS) has undergone major changes in its membership and its financial practices. FIRREA opened membership in the System to commercial banks and credit unions for the first time. Currently, commercial banks, credit unions, and state chartered thrifts are voluntary members of the FHLBS. Federally chartered thrifts, however, are required to be FHLBS members. Voluntary members currently comprise about 80 percent of the System's total members.

System membership continued its strong growth in 1995, with commercial banks now comprising 62 percent of total members. The System included 5,690 members at year-end 1995, a net increase of 383 members over the year-end 1994 total. Membership in the Federal Home Loan Bank System has expanded by 77 percent since membership eligibility was first extended to commercial banks and credit unions in 1989.

The Federal Home Loan Bank System's financial performance and condition continued to be strong in 1995. Outstanding advances to members reached \$122.1 billion at year-end 1995, up from \$116.2 billion at the

NEW DIRECTIONS IN THE SINGLE-FAMILY MORTGAGE INDUSTRY

Several trends are rapidly reshaping the single-family mortgage industry: consolidation among lenders, new technologies that promise to reduce the cost of and expedite the origination process, greater origination of higher-risk loans, and growing use of credit scoring to manage risk. These trends are likely to transform the industry in fundamental ways by the end of the decade. The rapid pace and multidimensional nature of these changes are making risk management more complex for all parties, including the Federal Government.

Consolidation among mortgage originators and servicers has accelerated since the waning of the 1992–93 refinancing boom. According to data published in *Inside Mortgage Finance*, the 25 largest originators increased their collective share of the market from 31 percent at year-end 1992 to 38 percent at year-end 1995, while the market share of the 25 largest servicers rose from 28 percent to 38 percent in the same period. Originators and servicers are enlarging their operations to achieve the economies of scale or, deciding that they cannot compete, are exiting the industry. At the same time, some banks are increasing their investment in mortgage lending, often through the acquisition of mortgage banking subsidiaries.

Many originators are taking advantage of new technologies to redesign how they make loans, reducing underwriting and processing costs and slashing the time between loan application and closing. Some originators are offering their services through real estate brokers and home builders, on computer networks, or at video kiosks in shopping malls or at financial institution branch offices. The reengineering of the origination process will soon allow many borrowers to have their loans approved very quickly without ever entering a lender's office.

The proportion of newly originated conventional (not federally insured or guaranteed) mortgages that pose a high level of credit risk has been increasing.

- Borrowers have been making lower downpayments, which mean that the ratios between loan principal and collateral value (LTV ratios) are higher, posing greater credit risk for lenders. The proportion of conventional mortgages with LTV ratios over 90 percent rose from 7 percent in 1989 to 27 percent in 1994. The average LTV ratio of conventional mortgages rose from 75 percent in 1989 to over 80 percent in 1995. Data from Freddie Mac indicate that the default rates of conventional mortgages with LTV ratios over 90 percent are six times higher than the default rates on conventional loans with 80 percent LTV ratios.
- Depository institutions, Fannie Mae, and Freddie Mac have increased their commitment to affordable lending programs that allow borrowers to make downpayments of 5 percent or less while loosening other underwriting guidelines. Compensating factors lessen, but may not wholly offset, the resulting increase in risk.
- When the volume of single-family originations declined by 24 percent in 1994 and further in 1995, many originators entered the markets for home equity loans and lines of credit and for first mortgage loans to borrowers with checkered credit histories (so-called B- to D-quality loans), causing the volume of such loans to increase.

The use of credit scoring in the single-family mortgage market will increase at an accelerating rate in the next few years. Credit scores are numerical assessments that rank borrowers by their relative default risk. Scores are calculated by statistical models that use information proven to be predictive of loan performance drawing on data from borrower credit reports to predict a borrower's future performance on consumer debt (auto, credit card, or installment debt) or on a mortgage loan.

Credit scores have been used to evaluate applications for nonmortgage debt for nearly 40 years, but have been used in single-family mortgage lending only in the last five years. Industry research has found a strong relationship between low consumer credit scores at origination and the likelihood of future default on mortgage loans. Fannie Mae has found that, although borrowers with scores below 620 represent only a small percentage of all borrowers, as a group they account for about 50 percent of the defaults that eventually occur.

In 1995, first Freddie Mac and then Fannie Mae urged lenders to use generic credit scores in the underwriting process, provided guidance about how lenders should do so, and indicated that they would use consumer credit scores as part of the post-purchase review process. The potential benefits of scoring and the commitment of Fannie Mae and Freddie Mac to using credit scores are likely to accelerate the industry's development and use of scores.

end of 1994. Total System capital at the end of 1995 was \$14.7 billion, compared to \$12.9 billion at the end of 1994. For calendar year 1995, the System's reported net income rose to \$1.2 billion, up from \$0.9 billion in 1994. Return on equity in 1995, after adjustment for payment of interest to REFCorp and other expenses, was approximately 6.5 percent.

The Federal Home Loan Banks are required to pay the greater of \$300 million or 20 percent of their annual net income to help pay the cost of interest on bonds issued by the Resolution Funding Corporation, REFCorp. REFCorp was created by FIRREA to provide initial capital for the Resolution Trust Corporation. The need to generate income to meet this obligation to REFCorp and provide a return on members' investment is a driving force behind the large increase in the System's investment activity in recent years. Investments

other than advances were \$146.8 billion as of December 31, 1995, an increase of 28 percent over just one year earlier. Thus, the need to generate the funds to pay REFCorp has encouraged the System to expose itself to new kinds of risk and resulted in a departure from the System's focus—making advances to members.

Historically, the System's exposure to credit risk has been virtually nonexistent. All advances to member institutions are collateralized, and the FHLBanks have the ability to call for additional or substitute collateral during the life of an advance. In the over sixty years of the System's existence, no FHLBank has ever experienced a loss on an advance. The System's increasing investment activities, however, have added new sources of credit risk, for example, to the extent that there is a risk of default by the FHLBanks' counterparties to off-balance sheet interest rate exchange agreements.

The System is also exposed to interest rate risk. The Financial Management Policy issued by the FHLBanks' regulator, the Federal Housing Finance Board, requires the FHLBanks to take a number of specific steps to manage their interest rate risk. The FHLBanks manage their interest rate risk by analyzing the sensitivity of the market value of their equity to changes in interest rates, charging prepayment fees on advances to members, restricting the types of mortgage-backed securities that they can invest in, and using interest rate exchange agreements. The System's exposure to risk will continue to be monitored carefully to ensure that it remains safe and sound.

Despite the System's current profitability and apparent strength, there is a need to strengthen the capital structure of the System in order to protect against future downturns. The Housing and Community Development Act of 1992 required that studies of the FHLBS be performed by the Congressional Budget Office, the General Accounting Office, the Department of Housing and Urban Development, the Federal Housing Finance Board, and System shareholders. All of these studies agreed that risk-based capital standards should be adopted for the System.

In response to these studies of the FHLBS which were completed in 1993 and 1994, last year the Administration and Congress proposed legislation to reform and modernize the Federal Home Loan Bank System. Both legislative proposals addressed the System's mission, capital structure, and capacity to pay interest obligations on the REFCorp bonds. The House of Representatives conducted hearings on the two proposals in 1995, and it is anticipated that the issue will be taken up again in 1996.

The Administration's proposal attempts to keep the System safe, sound, and focused on its public purpose. It would maintain the System's important role in housing finance, particularly its role in supporting portfolio lending. It would make System membership fully voluntary, with equal rights and responsibilities for all members. Perhaps most importantly, the Administration's proposal would enhance the safety and soundness of the System by creating minimum capital standards, including risk-based capital requirements, for each Federal Home Loan Bank and for the System as a whole, and by instituting a set of procedures for correcting capital deficiencies.

The role and risks of the FHLBS must continue to be examined and monitored in the face of rapidly changing financial markets. The increased use of credit scoring systems by mortgage lenders may eventually lead to less of a role for portfolio lenders in housing finance markets. In addition, it is important to continue to evaluate the System's role in housing finance in light of potential changes in the structure of the industry it serves.

Federal Housing Administration (FHA)

Trends in Program Size. As the national surge in single-family refinancing business ebbed in 1995, com-

mitments in the FHA Mutual Mortgage Insurance (MMI) single-family program fell to \$50 billion in 1995, after a volume of \$89 billion in 1994. FHA service to low-income and minority home buyers, however, remained strong. The proportion of FHA-insured home purchase loans to African-American and Hispanic home buyers continued at more than twice the proportion of conventional home purchase loans to these groups, and increased from 1994 to 1995.

National Homeownership Strategy. In June of 1995, the President announced a National Homeownership Strategy to add up to 8 million new families to America's homeownership rolls by the end of the year 2000, lifting the country's homeownership rate to an all-time high. This Strategy will strive to eliminate barriers that prevent lower-income working families, minorities, and immigrants from becoming homeowners. For example, it will actively promote wider use of flexible underwriting criteria, which would allow more buyers to qualify for mortgages, and it will increase homeownership counseling programs, which help first-time buyers find homes, qualify for mortgages, and budget their incomes to meet their mortgage payments.

FHA will be a full partner in this Strategy. In 1995, FHA took action to increase the availability of affordable homeownership, particularly in the central cities, by simplifying its rehabilitation mortgage insurance program, and establishing the Single Family Property Disposition program to sell FHA-foreclosed homes at a discount to nonprofit groups for rehabilitation and resale to lower-income buyers.

FHA as a Performance-Based Organization. In 1997, the Administration will seek to transform FHA into a "Performance-Based Organization" with flexibility in human resources management, procurement, and other administrative functions. FHA will continue to operate within HUD; it will be led by executives operating under term, performance-based contracts negotiated by the Secretary.

FHA Assignment Alternative. FHA is now preparing to implement legislation, expected to be passed soon by the Congress, establishing an alternative to FHA's current assignment program for delinquent borrowers. Currently, if an otherwise qualified FHA homeowner experiences temporary financial trouble and becomes 90 days delinquent, FHA can pay a full claim on their behalf and take over servicing of the mortgage. The borrower is then allowed up to 3 years to bring the loan to current status. The proposed alternative would provide FHA with tools to encourage private lenders to forebear instead of assigning the mortgage to HUD. This alternative would improve the targeting and efficiency of forbearance, while allowing FHA homeowners experiencing temporary economic distress to stay in their homes.

Potential Effects of Credit Scoring. As the use of credit scoring in the underwriting of conventional

mortgages increases, some borrowers who have little cash but excellent credit histories and would have traditionally been served by FHA's single-family mortgage insurance program will find that they are eligible for conventional financing on attractive terms. More importantly, applicants who have checkered credit histories will face tighter conventional underwriting constraints and may often be unable to obtain a conventional loan unless they can make downpayments of 20 percent or more. Those who can not and whose mortgages are small enough to qualify for FHA insurance will be shifted to FHA. Although the magnitude of this potential shifting of credit risk to FHA is uncertain, research on the relationship between consumer credit scores and likelihood of mortgage default suggests that it could significantly increase FHA default rates.

Sale of Single- and Multi-Family Assets. In March, 1994, the FHA launched an aggressive program to sell HUD-held mortgages. The goals of the program are to maximize value of HUD-held assets and assist in redeployment of its staff and resources to manage the insured portfolio, particularly in light of downsizing of the organization. The initiative was a key element in the Administration's larger effort to reinvent HUD. To date, FHA has sold 769 multi-family mortgages, 28,243 single family mortgages, and 2,700 Title I notes. These mortgage sales have not only succeeded in streamlining the agency's operation and management, they have generated proceeds which exceed the expected value to HUD (if the loans were held) of more than \$500 million in 1995. In 1996 and 1997 FHA plans to sell an additional 600 multi-family and 65,000 single family mortgages with a total outstanding principal balance of approximately \$6 billion.

Multi-family Portfolio Reengineering. Last year, the Administration proposed "Mark-to-Market," legislation intended to address long-standing problems in the portfolio of properties which have mortgages insured by FHA and also receive rental subsidies for low-income tenants. This Budget includes a proposal, "Portfolio Reengineering," which retains many of the features of last year's proposal. The core principles of this initiative are the use of market incentives to improve the efficiency and quality of assisted housing and expanded housing choices for residents and communities. This initiative would recognize economic losses that have occurred in FHA's multi-family portfolio, eliminate over-subsidization of some properties, and provide an orderly way of managing its restructuring. This portfolio provides housing to nearly 850,000 lower-income households in 8,500 privately owned but HUD-subsidized projects, who would be protected if eligible by receiving housing subsidies.

This initiative will generate savings in rental subsidies since many properties receive subsidies in excess of market rents. Allowing the rents of projects to adjust to market levels will in some cases reduce project income and necessitate writing down the mortgages of these properties to reflect their true economic value.

This will result in claims being paid out of the FHA fund. HUD will use third-party partners to produce efficient and proactive mortgage restructuring. In 1997, HUD intends to focus restructuring on projects where contracts expire and the current rents are above market. The Administration is willing to discuss with Congress mechanisms to take account of consequences (including tax effects) for owners who enter into restructuring agreements with HUD. The effect of the proposal would be a savings of \$1.4 billion in claims costs.

Department of Veterans Affairs

Trends in Program Size. As interest rates declined in the 1990s, lending in DVA's loan guaranty program increased dramatically, from \$15.7 billion in 1990 to \$55 billion in 1994. It has since fallen, to \$22 billion in 1995. In the long term, loan volume in this program is driven by the size and composition of the veterans population. As this population continues to diminish over the next several years, loan volume is expected to fall gradually, from \$22 billion in 1995 to about \$20 billion in 2001.

Performance Measures. DVA uses a cross-section of several performance measures to track the status of its guaranteed loan portfolio and the quality of its management of this portfolio. For example, the early foreclosure rate, which is the percent of loans in foreclosure within three years of origination, measures the quality of underwriting. The foreclosure avoidance through servicing ratio, which is the percentage of seriously delinquent loans that do not go into foreclosure, measures the success of VA's supplemental servicing program at helping veterans keep their homes. The six-month pipeline of property in inventory measures the quality of property disposition.

Rural Housing Insurance Fund

The primary Rural Housing Service (RHS) programs are the Section-502 single-family direct and guaranteed loan programs and the Section-515 multi-family direct loan program. The 502 direct loan program provides qualified borrowers with loans for the purchase, rehabilitation, or repair of rural single-family homes. Participants qualify if their income is less than 80 percent of State median income, they live in a legislatively defined "rural" area, and they are unable to obtain credit at affordable terms from a private institution. The 502 guaranteed loan program guarantees up to 90 percent of a loan on an unsubsidized basis for the purchase of new or existing housing. The 515 program, which generally lends to private developers, finances both the construction of new rural rental housing and the purchase and rehabilitation of existing substandard rental housing. Units are occupied by low- and moderate-income households, elderly households, or handicapped individuals. Currently, re-authorization of the 515 program is needed in order for any new construction to be financed from 1996 appropriated funds.

Cost and Risk. The primary costs in the 502 guaranteed program come from loan defaults. The default rate is 7.5 percent, and an average of 21 percent of the principal amount of the defaulted loan is not recovered. Both direct loan programs subsidize loans by setting interest rates below the Treasury rate. The primary cost in the direct programs is due to the interest rate subsidy. The rate charged 502 borrowers depends on their income; currently, the average effective interest rate for the outstanding subsidized portfolio is 3.4 percent. A 515 borrower's effective interest rate is generally fixed at 1 percent.

The riskiness in the RHS portfolio is most notable in the 502 direct loan program, whose risk is significantly greater than for conventional private sector loans for two reasons. First, RHS lends to very low- and moderate-income households who, as an eligibility requirement, are unable to obtain private credit. Second, because RHS' interest rate is periodically adjusted for changes in the borrower's income, the underlying costs of the outstanding portfolio change as borrowers' ability to pay changes. During economic slowdowns, incomes go down, more defaults and delinquencies are likely, and the effective interest rate paid by borrowers drops. At the same time, the 502 interest subsidy costs increase.

Progress in Reducing Costs. RHS implemented a new rule in 1996 that would save costs in the 502 direct loan program. Two major changes include how RHS determines repayment ability and the amount of payment assistance that a borrower receives. Instead of using a family budget to determine repayment ability, RHS now uses two expenditure-to-income ratios.

The loan principal, interest, taxes and insurance (PITI) cannot exceed 29 percent of adjusted family income for very low income borrowers and 33 percent for low income borrowers. The total debt ratio (TD) is capped at 38 percent of income for all borrowers. This reduces the complexity of making loans, is more objective, and imposes a smaller administrative burden. RHS also implemented an escalating interest rate structure which insures that lower payment assistance is provided as borrower income increases.

RHS has also begun implementing the Dedicated Loan Origination Service (DLOS), consolidating the servicing of the 502 direct single family housing loan portfolio in one location, rather than in county offices. DLOS objectives include establishing an escrowing system; reducing the foreclosure rate; lowering delinquency rates, loan losses and operating costs; and bringing the accounting more in line with the commercial sector. The new efficiencies will improve servicing of the portfolio with 1,500 fewer employees. The current implementation plan would save approximately \$250 million from 1996–2000. The 1997 subsidy rate reflects the .83 percentage point reduction in the subsidy rate that is a direct result of the DLOS-related changes.

For 1997, RHS will propose a "balloon payment" for the 515 Multifamily housing loan program. The proposal would require that all new 515 loans be for 30 years while amortized over 50 years. This would create a lump sum payment in the 30th year for the balance of the loan. This legislative proposal would lower the 515 loan subsidy rate by 8 percentage points because of the accelerated repayment to the Treasury that occurs in the 30th year.

VII. Federal Insurance Programs

Deposit Insurance

Federal deposit insurance was instituted in the 1930s to protect individual depositors from losses caused by failures of insured institutions. Deposit insurance also protects against widespread disruption in financial markets by reducing the probability that the failure of one financial institution will lead to a cascade of other failures. The Federal Deposit Insurance Corporation (FDIC) insures the deposits of banks and thrifts through two separate insurance funds, the Bank Insurance Fund (BIF) and the Savings Association Insurance Fund (SAIF). Deposits of credit unions are insured through the National Credit Union Administration (NCUA). Currently, deposits are insured up to a limit of \$100,000 per account.

The 1980s and early 1990s were a turbulent period for the bank and thrift industries, with over 1400 bank failures and 1100 thrift failures. The Federal Government responded with the Financial Institutions Reform, Recovery and Enforcement Act (FIRREA) of 1989 and the Federal Deposit Insurance Corporation Improvement Act (FDICIA) of 1991. These legislative reforms, combined with more favorable economic conditions,

helped to restore the health of depository institutions and to enhance public confidence in the deposit insurance system.

Prior to the enactment of FIRREA, thrift deposits were insured by the Federal Savings and Loan Insurance Corporation (FSLIC). FIRREA abolished FSLIC and established the Resolution Trust Corporation (RTC) as a temporary agency to handle the unprecedented number of failures created by the thrift crisis. In July 1995, responsibility for handling new thrift failures was transferred from RTC to SAIF, and the remaining assets and liabilities of RTC were transferred to FDIC's FSLIC Resolution Fund on December 31, 1995. During its life, the RTC handled over 747 failed thrifts with over \$400 billion in assets, at a cost to taxpayers of about \$90 billion.

Current Industry and Insurance Fund Conditions. The National Credit Union Share Insurance Fund continues to remain strong with assets of \$3.4 billion. In fiscal year 1995, the income generated from the 1 percent deposit eliminated the need to assess the annual premium. In fact, earlier this year the Fund

paid a \$106 million dividend to federally insured credit unions due to an excess over the 1.30 percent reserve requirement. The level of reserves had reached 1.33 percent at the end of fiscal year 1995. In addition, the Fund did not report any insurance losses from failed credit unions during fiscal year 1995. For insurance year 1996, the required annual insurance premium of one-twelfth of 1 percent of total member share accounts has been waived.

The health of the banking industry has improved dramatically over the last few years. Banks achieved record levels of earnings in 1993 and 1994. This strong performance enabled banks to recapitalize the BIF, which reached its statutorily-designated reserve ratio of 1.25 percent in mid-1995. As a result of BIF's recapitalization, the FDIC has lowered deposit insurance premiums for banks. The rate for the healthiest banks is currently only the statutory minimum of \$2,000 per year.

The earnings of the thrift industry also have showed strong improvement in the last few years. The thrift industry reported net income of \$1.2 billion in 1991, \$5.1 billion in 1992, \$4.9 billion in 1993, and \$4.3 billion in 1994. For the first nine months of 1995, the industry reported net income of \$3.2 billion. Despite the continued profitability of the industry, the long-term outlook for thrifts is uncertain. Deposit insurance premiums for thrifts remain high, at 23 cents per \$100 of deposits for the healthiest thrifts. Thus, a healthy thrift with \$100 million in deposits would pay \$230,000 for deposit insurance this year, while a healthy bank of the same size would pay only \$2,000. This large disparity between the deposit insurance premiums paid by banks and thrifts threatens to destabilize the thrift industry and its deposit insurance fund, SAIF. In addition, the thrift industry remains vulnerable to geographic asset concentration, swings in interest rates, and increasing competition from banks and other financial institutions.

In contrast to BIF's recapitalization, SAIF's reserve ratio stood at about 0.46 percent at the end of fiscal year 1995, only about one-third of the required 1.25 percent. One reason that SAIF's reserves have grown so slowly compared to BIF's is that SAIF-insured institutions are obligated under current law to pay the interest on Financing Corporation (FICO) bonds that were used to finance part of the cost of the recent thrift crisis. The SAIF is required by law to maintain its premium rates at about 23 cents per \$100 of deposits until the fund is recapitalized. The FICO obligation currently consumes about 45 percent of premium income that would otherwise be available to build up the reserves of SAIF.

The Administration's Proposal to Address the Problems of SAIF. The Administration projects that the current 23-basis point differential between SAIF and BIF insurance premiums will have a detrimental effect on SAIF's assessment base. Because of the differential, thrifts have an incentive to find ways of reducing their reliance on SAIF-insured deposits. Thrifts

might do this by shifting deposits to BIF-insured affiliates, shrinking their balance sheets, or relying more heavily on non-deposit liabilities such as advances from the Federal Home Loan Bank System. Preliminary evidence indicates that thrifts are indeed moving to reduce their reliance on SAIF-insured deposits. As the available SAIF assessment base shrinks, the proportion of SAIF's premium income that must go to pay FICO obligations will increase. Within only a few years, the portion of SAIF premiums available to pay FICO interest could be insufficient to cover the \$793 million annual cost.

Without legislative action, the current BIF-SAIF premium disparity will persist for many years. The Administration does not currently project that SAIF will recapitalize on its own within the 10-year budget horizon. Even more optimistic forecasts do not project that SAIF will recapitalize within the next 5 years. Even if SAIF recapitalizes on its own without legislation, a significant premium disparity would continue to exist until 2019 because of SAIF-insured institutions' obligation to pay FICO bond interest.

Last year, the Administration proposed legislation to remedy the problems of SAIF. The main elements of the proposal are a one-time special assessment on SAIF-insured deposits to immediately bring SAIF's reserve ratio up to the required 1.25 percent, a requirement that the FICO interest payments be shared across banks and thrifts on a pro rata basis, and a merger of BIF and SAIF. Congress adopted a very similar proposal in its seven-year balanced budget plan. As the prospect of a significant BIF-SAIF premium disparity has become reality, and preliminary evidence that the deposit insurance premium disparity is having a harmful impact on SAIF's assessment base has emerged, the Administration believes it is increasingly urgent that action be taken to address this problem through legislation like that proposed by the Administration last year.

Projecting Deposit Insurance Losses in a Changing Environment. Predicting failures of depository institutions and the associated impact on the deposit insurance funds is a significant challenge. In recent years, rapidly changing conditions in depository institutions' operating environment have made predicting insured institution failures more difficult. First, depository institutions face increasing competition from non-bank financial institutions. Depository institutions are responding to this challenge by changing their products, investments, and their role in the economy. Second, it is extremely difficult to assess the potential impact that increasing off-balance sheet activity, such as investment in derivatives, has had on the risk exposure of the deposit insurance funds. Finally, it is too soon to tell with certainty how much the legislative changes of the past few years will affect deposit insurance losses. For example, stricter regulatory and capital requirements imposed by FDICIA should have the long-term effect of reducing losses borne by the deposit insurance funds.

The Administration is continuing to examine and monitor the effectiveness and efficiency of the current regulatory system. In addition, the Administration will continue to study the need for policy changes to protect the health of the deposit insurance funds, to improve the long run profitability of the bank and thrift industry, and to support the growth of the financial services sector.

Pension Insurance

The Pension Benefit Guaranty Corporation (PBGC) insures defined benefit pension plans of private employers. PBGC steps in when a company becomes insolvent and its pension plan cannot pay the full value of benefits guaranteed by law. At any given time, PBGC's exposure to claims relates to the underfunding of pension plans, that is, to any amount by which expected future benefits exceed plan assets.

The Retirement Protection Act (RPA), signed into law December 1994, strengthens pension safeguards and improves program operations. The RPA:

- requires companies to accelerate their contributions to underfunded plans;
- more fairly relates the premiums that companies pay to PBGC's exposure by increasing insurance premiums for those pension plans that are the most underfunded;
- requires privately-held companies with seriously underfunded plans to give PBGC advance notice of any transactions that potentially are harmful to their plans. When this "Early Warning Program" shows benefits to pensioners to be seriously at risk, PBGC begins negotiating funding and other arrangements in order to forestall its taking over the plan.
- standardizes both the interest rates and the mortality tables that companies use to calculate: (1) any underfunding, (2) the premiums to PBGC, and (3) the companies' legally required funding contributions to their plans.
- expands PBGC's "missing participants" program. Some workers about to retire simply forget about the pensions they have earned at a job many years past; some plans may have become insolvent; and some plans may be unable to locate retirees. When a company either has failed or cannot locate a previous employee entitled to a pension, PBGC endeavors to locate the missing participant and then pays the benefits owed.

The long-term impact of these pension reforms should be significant. Having successfully improved the PBGC insurance program, no additional reforms of pension insurance are included in the budget. However the Administration will continue to explore better methods for quantifying, forecasting, and pricing the Federal cost of pension insurance.

Over the past three years under the Early Warning Program, PBGC has negotiated 30 major settlements that provided \$13 billion in new pension contributions from companies. The added contributions strengthened

pension security for one million people. In 1995, the Early Warning Program was one of the first six Federal programs to receive an award from the Ford Foundation and Harvard's Kennedy School of Government. The program also received the National Performance Review's Hammer Award.

Legislation passed by the Congress in 1995 would have allowed "pension asset reversions" whereby companies could take money out of pension plans that at the time are considered to be overfunded (i.e., if assets exceeded 125 percent of actuarial liability). Those companies could effectively devote to any purpose the money they withdrew.

In the early- and mid-1980s (until reversions were greatly restricted), \$20 billion was withdrawn from pension funds. The lure of quick cash made some companies with "overfunded" plans the target of hostile takeovers. In other cases, one company would finance a leveraged buyout of another by taking a reversion from its own plan. Some of these overfunded plans then became underfunded later.

The 1995 legislation could have led to the removal of \$15–18 billion in pension assets for non-retirement purposes. But overfunded plans can quickly become underfunded with fluctuations in interest rates and with fluctuations in the value of stocks and the value of other financial assets. PBGC has estimated that an interest-rate drop of two percentage points could reduce a plan's funding level from 125 percent down to as little as 92 percent.

Concerned that this legislation would undo the reforms of the previous year, the President vetoed it. And in his 1996 State of the Union address, he said that he would veto reversion proposals again.

Happily, for the first time in a decade, the continued growth of underfunding in insured pension plans has reversed. Data collected for 1994—and reported late in 1995—showed pension underfunding dropping to an estimated \$31 billion, from \$71 billion for 1993. Much of this underfunding is in plans of financially healthy companies, but approximately \$11 billion is in plans sponsored by companies with bonds rated at below investment grade.

Underfunding fell in 1994 primarily because of the rise in interest rates, which reduced pension liabilities. The other important factor was companies' additional pension contributions—almost \$12 billion above the required amount—which often were prompted by the Early Warning Program. Of course, underfunding has not disappeared; it can easily rebound with future decreases in interest rates. But the RPA is intended to resist this future risk; now as it is being phased in, it is accelerating company contributions to underfunded pension plans.

Natural Disaster Insurance

In recent years, there has been growing recognition that new policies are needed to reduce the high cost of natural disasters to society; to the Federal, State, and local governments; and to insurance companies.

Since September 1989, private insurers have paid out over \$35 billion in claims, and the Federal Government has paid a roughly similar amount for seven major disasters. In addition, individuals and businesses have incurred huge costs as well.

Although the Federal Government provides flood and crop insurance and private insurance companies cover other types of disasters, there are still widespread gaps in disaster coverage. Homeowners' policies, for example, generally do not cover shake damage from earthquakes or wind damage in hurricane-prone States. Although these are available as supplemental riders at additional cost, homeowners often do not purchase coverage, in part because of the perceived high cost. At the same time, some insurance companies have attempted to reduce or even pull out entirely from the insurance business in high-risk disaster areas because they cannot charge rates sufficient to cover expected losses.

In order to respond to this situation, in February 1995 the Administration proposed an integrated, comprehensive set of recommendations for legislation to deal with disaster assistance and disaster-related insurance. The major elements of the proposals would: reduce the losses from natural disasters by encouraging communities to enhance and upgrade their building codes; fund cost-effective retrofit of public buildings used for critical functions in high risk areas; reform Federal post-disaster assistance; require that, after a phase-in period, most homeowners purchase insurance to cover all natural disasters except floods; and auction Federal excess-of-loss contracts to insurance companies.

Under these contracts, insurance and reinsurance companies that suffer losses and purchased a contract would receive a payment from the Federal Government if there were a catastrophe that caused industry losses between \$25 to \$50 billion. The objective of the contracts is to enable insurance companies to expand their underwriting of homeowners' policies by reducing the risk that a huge disaster might push a company into insolvency. The program would be fully funded by the auction receipts; there would be no Federal subsidy or adverse budget scoring impact.

The Administration is working with Congress, the insurance industry and other interested groups to produce effective legislation that addresses the multifaceted issues involving disaster insurance. It is especially important that such legislation not create a new, costly Federal insurance program, that it explicitly define and bound any Federal liability, and that it enable the Federal Government to respond flexibly and appropriately after a catastrophic event. The Administration's proposal meets these criteria.

National Flood Insurance

The Federal Government provides flood insurance through the National Flood Insurance Program (NFIP) administered by the Federal Emergency Management Agency (FEMA). The NFIP provides flood insurance to property owners living in communities that have adopted and enforced appropriate floodplain management

measures. Policies for structures built before a community joined the flood insurance program are by law subsidized, while policies for structures built after a community joins the NFIP are actuarially rated.

The flood insurance program was created in the early 1970s principally because damage from flooding was increasing. Because communities were not adopting building standards and there was insufficient information on the risks of flooding in each geographic area, private insurance companies had deemed flood risk uninsurable. To address these concerns, the NFIP was established to provide insurance coverage, to require loss mitigation efforts designed to reduce flood damage, and to begin a flood hazard mapping project to quantify the risk of flooding in each geographic area. The Federal flood program has been successful in meeting these goals.

In 1997, the NFIP plans to increase premiums to policyholders to implement expanded mitigation insurance authorized by the National Flood Insurance Reform Act of 1994. The mandatory Increased Cost of Construction (ICC) coverage will allow substantially-damaged structures to be rebuilt in accordance with existing floodplain management requirements. This will reduce future losses and allow the structure to be actuarially rated.

To increase compliance with flood insurance purchase requirements, the 1994 Reform Act also imposed significant new obligations on both mortgage originators and servicers, including mandatory escrow requirements for flood insurance, and mandatory provisions for "forced placement" of flood insurance. In addition, it required that Fannie Mae and Freddie Mac implement procedures to assure that loans they purchase are covered by flood insurance for the life of the loan. Many of the reforms affecting the financial community were implemented in 1995.

In the past, appropriations were required to replenish the program's borrowing authority when income to the flood insurance fund was insufficient. Since 1986, FEMA has not requested appropriations; however in early 1996, the NFIP had to borrow substantially from the Treasury to cover claims. Several major floods over the past few years led to extremely high losses and substantially depleted the fund's reserves.

Federal Crop Insurance Program

Subsidized Federal crop insurance helps farmers in managing catastrophic yield shortfalls due to adverse weather or other natural disasters. Private sector companies are unwilling to offer multi-peril crop insurance because losses tend to be correlated across geographic areas, and the companies are therefore exposed to large losses. For example, a drought will affect many farms at the same time. Damage from hail, on the other hand, tends to be more localized, and a private market for hail insurance has existed for over 100 years. The Federal program was operated as a pilot program up to 1980, when the program was expanded nationwide to most major crops. The program is a cooperative effort

between the Federal Government and the private insurance industry. The Federal Government reimburses private insurance companies for a portion of the administrative expenses associated with extending crop insurance and reinsures the private companies for excess insurance losses on all policies. Private companies sell and adjust crop insurance policies.

In 1994, a major program reform was enacted to address a growing problem caused by the availability of Federal ad hoc disaster payments. Between 1980 and 1994, participation in the crop insurance program was kept low by the availability of post-event disaster aid from the Federal Government. Because disaster payments were grants to affected individuals, farmers had little incentive to purchase Federal crop insurance. As a result, the cost of ad hoc disaster payments rose over the past seven years, and the crop insurance program accumulated an \$8 billion actuarial deficit. The 1994 reform repealed existing agricultural disaster payment authorities and authorized a new catastrophic insurance policy that indemnifies farmers at a rate roughly equal to the previous free disaster payments. The catastrophic insurance policy is free to the farmer except for an administrative fee. Private companies may sell and adjust the catastrophic portion of the crop insurance policy, and also provide higher levels of coverage (which are also federally subsidized). In addition, the reform required participants in other Federal farm programs to purchase crop insurance, at least at the catastrophic coverage level. This was intended to improve the actuarial soundness of the program by reducing adverse selection in the crop insurance program.

The reform was implemented in crop year 1995. To date, no ad hoc disaster assistance bill has been enacted for the 1995 crop, although several bills were introduced. This is the first time in over 10 years that an ad hoc crop disaster assistance bill has not been enacted. However, the Administration, in response to a wet spring in the Midwest, announced changes to the underlying crop insurance policy in 1995 without corresponding premium changes. These changes, additional "prevented-planting" coverage, were essentially post-event changes. Based on the most recent loss settlement data from crop year 1995, these changes added roughly 20 basis points to the 1995 loss ratio, or roughly \$225 million to total indemnities.

While the underlying risk of the crop insurance program remains large, the actuarial performance is much improved in the past two years. Crop year 1994 was the first year that the loss ratio for crop insurance program was below 1.0; the historical average is 1.4. The 1995 loss ratio for the entire line of insurance business is estimated to be 1.05. That is, for every dollar in premium, indemnity payments of \$1.05 will be made. Absent the prevented-planting changes mentioned above, the loss ratio would have been below 1.0 for the second year in a row. In large part, the 1995 loss ratio is lower than historical levels because of the additional business in 1995, a direct result of the reform, and the changes that have been made over the

past 3 years in the methods for setting individual farm yields and premium rates.

A 1996 Farm Bill may further change the program. As this document was being prepared, Congress was considering a Farm Bill that would sever the link between farm program eligibility and crop insurance. It would reverse a fundamental 1994 reform, in that farmers would again not be required to buy crop insurance. The Administration has expressed its objection to this provision, as it may lead to a reversion to ad hoc disaster assistance and exacerbate adverse selection problems.

VA Life Insurance Programs

The Federal Government has provided life insurance to service members and veterans since World War I. These programs can be broadly divided into two categories: pre-Viet Nam, and Viet Nam and thereafter. DVA administers six programs of life insurance for veterans of WWI, WWII, and Korea, as well as for disabled veterans. About 2.8 million veterans are insured. Almost 80 percent of those insured through DVA are World War II veterans, and they are, on average, about 72 years old. Except for paid up additional insurance purchased with dividends, and certain disabled veterans' policies, insurance has a maximum face value of \$10,000.

Four of the DVA-administered programs operate essentially like mutual life insurance companies, with the trust funds' gains and savings returned to insureds as dividends. The other two programs are for disabled veterans and require an annual subsidy from an appropriated account (Veterans Insurance and Indemnities). The only programs that are still open to new issue are those for disabled veterans.

The cost-per-policy for administering DVA-run life insurance programs is approximately \$12, while the average cost of administering commercial policies was \$53 in 1994. The 1996 continuing resolution for DVA (P.L. 104-99), which is based on Conference action, provides that the administrative expenses of operating most of these programs will be paid from the trust funds—they have been funded from discretionary resources heretofore. DVA is currently reviewing whether there would be savings by privatizing these programs. As of this writing, the study is not complete.

The second broad category of life insurance is for current veterans and members of the service. Since 1965, VA has purchased a group policy from a commercial company. The commercial company is responsible for administration of these insurance programs and DVA provides oversight and program management. Servicemembers can be insured for up to \$200,000 under these programs, and can retain their coverage indefinitely after separation. All claims and expenses, except the extra hazards of military service are borne by the insureds (there have been no extra hazard payments since 1975).

The VA Insurance programs have laid out five key objectives in their business plan (under the auspices

of the Government Performance and Results Act). Performance indicators include customer surveys; measurements of timeliness and accuracy of service; complaint

rates; blockage rates and hold times on the Insurance nationwide toll-free lines; and other measures.

VIII. Implementing Credit Reform and Improving Debt Collection

Implementation of Credit Reform

The Federal Credit Reform Act (FCRA) of 1990 dramatically improved the budgetary treatment of credit programs. Because these changes were fundamental, implementation has been challenging. As the fifth year of credit reform nears completion, it is appropriate to review its implementation, successes, and next steps.

Prior to 1992, budget rules did not measure the true costs of credit programs. Outlays were measured on a cash basis. When direct loans were made, the budget recorded the full amount disbursed as an outlay; when they were repaid, the budget recorded the full amount repaid as an offset to outlays; and when loan guarantees were made, the budget recorded no outlay until default payments or other payments were made in later years, unless fees were received, in which case the budget recorded a reduction in outlays. Furthermore, many direct loans were disbursed from revolving funds, which had the authority to make new loans on the basis of repayments and interest received without needing new appropriations from the Congress. As a result, the cost of new direct loans was overstated; loan guarantee costs were understated; the budget did not accurately compare the costs of loans to guarantees, or credit programs to grants and other forms of assistance; and appropriations control was not exercised over much of the direct lending.

It was only with passage of FCRA in 1990 that credit programs were put on an equal footing with other programs. The budget now records the cost of the direct loan or loan guarantee when the loan is disbursed. The cost is defined as the net present value of the loan or guarantee: the present value of the estimated cash outflows due to the loan or guarantee over its life minus the present value of the estimated cash inflows. Cash outflows include the principal amount of direct loans disbursed, the payment of default claims, interest supplements paid to lenders, and so forth; cash inflows include the principal amount of direct loans repaid, interest received on direct loans, fees, recoveries on foreclosed property, and so forth. Appropriations are required before a program can incur subsidy cost, except for grandfathered mandatory loan programs such as student loans and veterans housing guarantees.²

FCRA therefore created incentives for managers and policy officials to ask the right questions: What is the most appropriate form of assistance for a given group of beneficiaries? What will this assistance cost? And, indirectly, what can be done to reduce the cost (subsidy) of existing assistance programs? It also created the in-

centives for the Executive Branch and the Congress to allocate resources where the benefits are greatest.

Agency Implementation. The merits of credit reform had been discussed for decades, but it could have been enacted in many different forms. When the FCRA was passed, most agencies were not prepared for the significant changes the law required. Credit reform affected agencies at many different levels. First, credit reform required agencies to rethink the way they budgeted and accounted for credit programs. The focus was no longer solely on output, but also on long-term program costs. Since most agencies had never estimated the long-term cost to the Government of their credit programs, developing subsidy estimates demanded extensive and unfamiliar analysis. Second, budget analysts and accountants had to quickly learn the mechanics of credit reform. Since OMB and Treasury guidance was in the formative stage, this was an on-going, and occasionally frustrating, process. Third, new accounting and reporting requirements obligated agencies to significantly modify their financial systems. Agencies met credit reform with varying levels of systems capabilities. Within existing resources, agencies attempted to alter their systems to meet the more complex credit reform requirements. Inevitably, there were many imperfections.

Financial Accounting Standards. In the same year that FCRA changed the budgeting for Federal credit programs, OMB, Treasury, and GAO (General Accounting Office) established the Federal Accounting Standards Advisory Board (FASAB) to recommend financial accounting standards for the Federal Government. If approved by the heads of these three agencies, these standards are effective for financial statements prepared under the Chief Financial Officers Act of 1990 and other financial accounting purposes. One of the earliest projects undertaken by FASAB was to develop accounting standards for Federal credit programs. The Board endorsed the logic underlying credit reform as appropriate for financial accounting as well as budgeting, and it recognized the value of having financial accounting support the budget. It therefore recommended accounting standards for credit that were consistent with budgeting under credit reform. Its recommendations were approved by OMB, Treasury, and GAO and published in August 1993 as Statement of Federal Financial Accounting Standards No. 2, *Accounting for Direct Loans and Loan Guarantees*.

Recent Initiatives

Over the past year, OMB and the agencies have focused on two areas: simplifying requirements and im-

²The structure of credit reform is further explained in Chapter VIII.A of the 1992 *Budget*, Part Two, pp. 223-26. For the distinction in budgetary treatment between the cost of credit programs and the financing of cash flows, also see chapter 11 of this volume, "Federal Borrowing and Debt," and chapter 20, "Off-Budget Federal Entities."

proving the quality of subsidy estimates. While significant progress has been made, both initiatives are ongoing.

Simplifying Requirements. OMB continues to work with agencies to streamline credit reform requirements. In February 1995, the five major credit agencies, OMB, and Treasury established the CFO Council Credit Reform Committee, which meets regularly to discuss methods for complying with credit reform at the lowest possible cost to the agencies. An initial set of recommendations has been made by the Committee, such as reducing the frequency of subsidy reestimates when the amount of the reestimates is expected to be relatively small. These recommendations were endorsed by the CFO Council and have already been partially implemented. OMB and Treasury have worked together on other streamlining initiatives, such as reporting data on budget execution for credit programs on the same forms as for other programs. This simplification, supported by the CFO Council Credit Reform Committee, is scheduled to go into effect later this year.

Improving the Quality of Subsidy Estimates. Credit reform is only as strong as agencies' subsidy estimates. Given the limited amount of time agencies had to comply with credit reform, early underlying subsidy assumptions, such as default and recovery rates, were rough at best. Over the past year, OMB has worked closely with agencies to improve their cost estimates. With the initial loans having been outstanding for several years, and some medium-term loans beginning to mature, it will be possible to judge the accuracy of previously projected cash flows by comparing the projected cash flows to the actuals.

Therefore, OMB has drawn increasing attention to the importance of reestimates. FCRA requires agencies to periodically update their subsidy estimates for previous loans and guarantees and to record the change in the estimated cost as an increase or decrease in outlays of the current year. The 1997 Federal Credit Supplement (issued with the President's Budget) will contain all previous reestimates, for the first time, and the last part of this section discusses the reestimate process and the reestimates made this year.

A further impetus toward accurate subsidy estimation is the requirement in the Government Management Reform Act of 1994 that the Treasury Department submit an audited financial statement for 1997 and subsequent years covering all accounts of the Executive branch of the Government. The General Accounting Office is required to do the auditing. GAO, Treasury, and OMB have established a task force to develop auditing guidance for these statements, and one of its subgroups is on direct loans and loan guarantees. This subgroup, composed of staff from GAO, Treasury, OMB, and several credit agencies, is working to provide guidance that will help to improve and standardize the auditing process. Audits will provide incentives for agencies to improve their databases, documentation, tracking, and estimation procedures, which should lead to stronger his-

torical data and more attention to the accuracy of cash flow projections.

Next Steps. Agencies have made great strides in implementing credit reform. However, few have utilized credit reform as a management tool. OMB is encouraging agencies to integrate credit reform concepts into internal management decisions. First, as outlined above, OMB is working with agencies to improve their subsidy estimates, through increased attention to subsidy rate assumptions and subsidy rate audits. Once agencies have developed historical databases, this same information can be used for internal management decisions. Second, OMB continues to place strong emphasis on credit reform training. As agencies become more comfortable working with credit reform concepts, compliance will improve. Third, the Federal Credit Policy Working Group will help agencies establish indicators to judge program performance within the framework of the performance measurement requirements of GPRA (Government Performance and Results Act of 1993). While the FCRA focuses on program costs, proper measures of performance focus not only on program costs, but also on program goals.

Subsidy Reestimates

As noted above, a key tool for improving the quality of subsidy estimates is the annual review of past subsidy estimates. With four years of credit reform completed (1992–1995), agencies now are able to better test the accuracy of their original subsidy estimates. Section 504(f) of FCRA requires that the subsidy cost for a cohort of loans (typically all loans approved in a fiscal year) be “reestimated” in subsequent years. If the reestimated cost differs from the original subsidy estimate, the subsidy funds for this cohort in the financing account must be increased or decreased to ensure that adequate resources—but no more—are available to cover the life-time costs of that cohort.

The authors of credit reform believed that agencies should be encouraged to make the most accurate subsidy estimates possible. Therefore, FCRA provided permanent indefinite budget authority to cover the cost of reestimates. While agencies are not penalized for the inaccuracy of past subsidy estimates in the appropriations they request from Congress, they are required to incorporate this improved knowledge into the subsidy estimates of future loan cohorts.

Findings from Recent Subsidy Reestimates. Since subsidy rates represent estimates of the Government's net present value of cash flows over future years, reestimates of the original subsidy cost are common. Due to changes in interest rates, economic conditions, and the projected timing of cash flows, some cohorts have already experienced both downward and upward reestimates during the past four years.

Table 8–2 lists the cost of reestimates for the past three years. While subsidy estimates as a whole were adjusted downward in 1994, reestimates in the last two years have required \$1.2 billion and \$238 million in

permanent indefinite budget authority respectively. The causes of reestimates in 1996 are discussed below.

Department of Education reestimates of prior year cohorts reflect the following factors: 1) lower interest rate projections; 2) revised projections for defaults, collections, and other technical assumptions; and 3) technical improvements in the Department's forecasting models. FFEL costs increased \$595 million under the 1996 reestimate, primarily because reductions in the discount rate increase the cost of future defaults; conversely, reestimated Direct Loan costs fell \$271 million because decreasing interest rates reduce Government borrowing costs.

As a result of the change in the financial condition of certain countries, as rated by the Inter-Agency Country Risk Assessment System (ICRAS), subsidy estimates of international lending was adjusted in 1996. For example, the subsidy cost of the Food For Progress program lending in Russia, which is financed by Commodity Credit Corporation, was adjusted downward by \$38 million. 1996 reestimates were adjusted upward by \$50 million for Export-Import Bank cohorts, because of a reduction in ICRAS ratings of certain countries where the agency has high exposure. Downward reestimates for the P.L. 480 loan program of \$37 million resulted from improved ICRAS ratings for several countries, as well as technical changes in the loan terms.

The Department of Veterans Affairs home loan programs incurred substantial upward and downward subsidy reestimates in 1996. Subsidy costs were reestimated upward by \$315 million due to an increase in estimated loan volume for 1995 and prior cohorts. Subsidy costs were reestimated downward by -\$710 million due in small part to changes in interest rates but mostly to an increase in the expected recovery rate on defaulted loans. Recent evidence suggests that DVA obtains 100 percent of appraised value when it sells property acquired through default.

Based on extensive data analysis over the past year, the Small Business Administration determined that its estimated subsidy cost of the Section 504 and 7(a) programs had been understated. Therefore, the subsidy cost of the 1992-95 cohorts has been increased by \$257 million. Consistent with this reestimate, the estimated subsidy cost of 1997 Section 504 and 7(a) loans has been increased.

Improving Debt Collection

In measuring costs of credit programs one critical element is the timing and amount of recoveries of defaulted loans. Recoveries are also an important element in measuring program performance. For the Federal Government, debt collection is especially significant since direct loans, loans acquired as a result of claims

Table 8-2. REESTIMATES OF CREDIT SUBSIDIES ON LOANS DISBURSED IN 1992, 1993, 1994, and 1995¹
(In millions of dollars)

Program	1994	1995	1996
Direct Loans:			
P.L. 480 Title I loan program			-37
Agriculture credit insurance fund	-72	28	
Agricultural conservation	-1		
Rural development loan program		1	
Rural electrification and telephone loans	*	61	1
Rural telephone bank	1		
Rural housing insurance fund	2	139	
Direct student loans			-271
VA-Guaranty and indemnity	7	8	16
VA-Loan guaranty direct loans	-46	22	60
Export-Import Bank direct loans	-28	-16	37
Loan Guarantees:			
AID housing guaranty		-3	
P.L. 480 Title I Food for Progress credits		84	-38
Agriculture credit insurance	5	14	
Commodity Credit Corporation export guarantees	3	107	
Rural development insurance fund	49		
Federal family education (formerly GSL)*:			
Technical reestimate	97	421	30
Volume reestimate ²			565
FHA-General and special risk	-175		
SBA-Business loans			257
VA-Guaranty and indemnity program:			
Technical reestimate	1	343	-710
Volume reestimate ²			315
Export-Import bank guarantees	-11	-59	13
Total	-168	1,150	238

¹ Additional information on credit reform subsidy rates is contained in the Federal Credit and Insurance Supplement to the budget for 1996.

² Volume reestimates in mandatory programs represent a change in volume of loans disbursed in the prior years. These estimates are the result of guarantee programs where data from loan issuers on actual disbursements of loans are not received until after the close of the fiscal year.

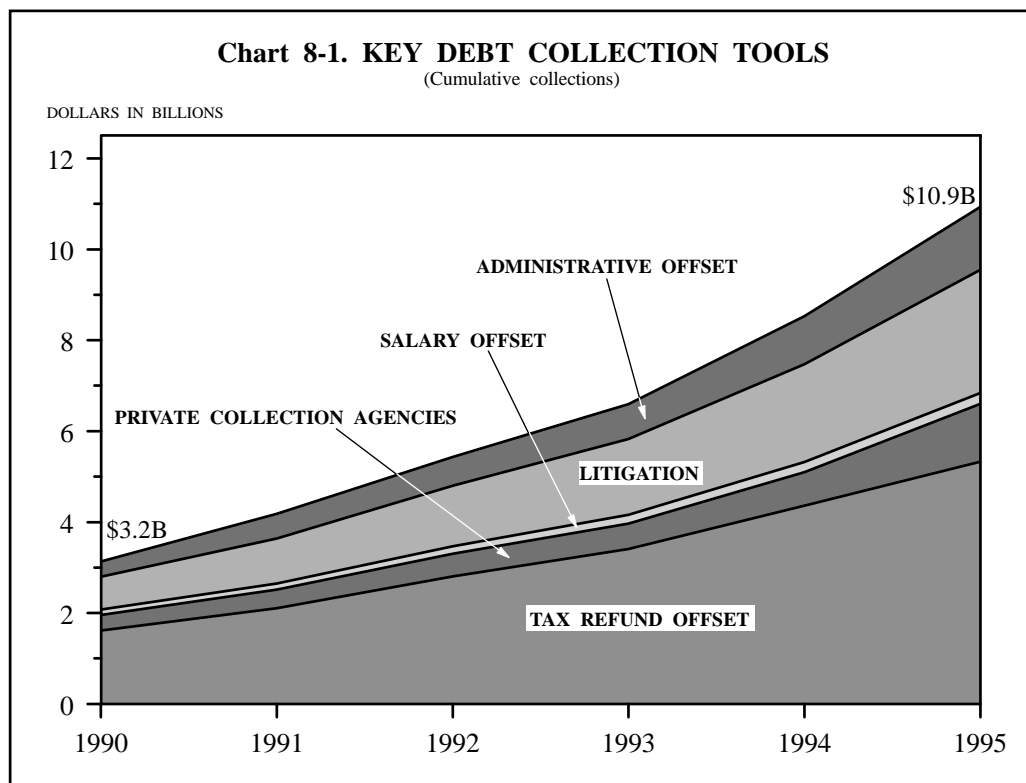
paid on defaulted guaranteed loans, and other receivables totaled \$256 billion at the end of 1995. Of that amount, \$51 billion were delinquent. This is an increase of over \$6 billion during 1995. Over \$43 billion have been delinquent for more than a year and collectibility is considered doubtful.

At each stage in the Government's credit and debt management program, there are specific tools that can be used to prevent default, convert delinquent accounts into repayment, and, if appropriate, enforce a Federal claim through the judicial system. As shown in Chart 8-1, using the key debt collection tools, cumulative collections increased by 28% from \$8.5 billion in 1994 to \$10.9 billion in 1995. The Tax Refund Offset program, which intercepts debtors' income tax refunds, collected over \$1 billion in 1995. The chart below depicts cumulate collections by the key debt collection tools from 1990 through 1995.

The Department of Education is a leader in the use of modern debt collection tools. During 1995, the De-

partment of Education collected \$605 million in defaulted student loans, an increase of over \$300 million from 1994. A total of \$2 billion in defaulted student loans was collected in 1995 through efforts from the Department of Education, IRS Offset, and the Guaranty agencies.

The Administration's proposed Debt Collection Improvement Act would create incentives for Treasury and other debt collection agencies to invest in systems that support improved electronic payment and collection of tax and non-tax delinquent debt. The proposed Debt Collection Improvement Act is designed to maximize collections of delinquent debts by ensuring quick action to enforce recovery of debts, and using all appropriate collection tools, including private sector services. The legislation would reduce losses by proper screening, aggressive monitoring of accounts, and sharing of information within and among Federal agencies.



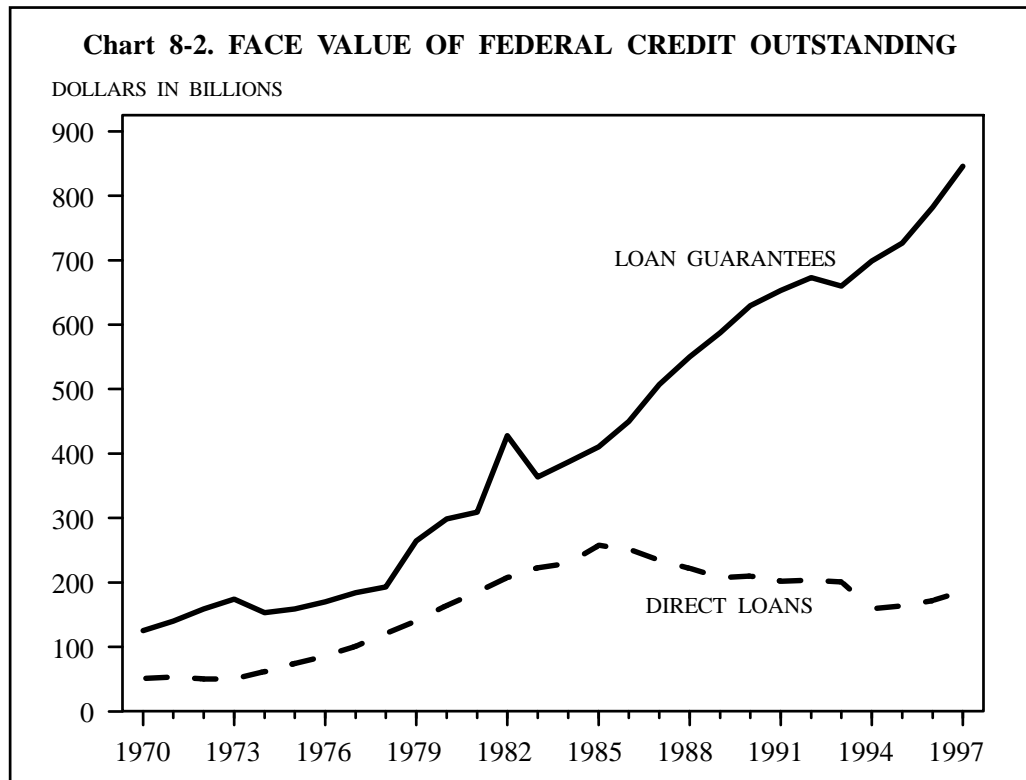


Table 8-3. ESTIMATED 1997 SUBSIDY RATES, BUDGET AUTHORITY, AND LOAN LEVELS FOR DIRECT LOANS¹

(In millions of dollars)

Agency and Program	1997 Weighted average subsidy as a percent of disbursements	1997 Subsidy budget authority	1997 Estimated loan levels
Funds Appropriated to the President:			
Micro and small enterprise development	12.20	—*	1
Foreign Military Financing	10.81	40	370
Overseas Private Investment Corporation	5.00	4	80
Agriculture:			
Agricultural credit insurance fund	12.85	70	546
Rural housing insurance fund	5.81	225	1,668
Rural economic development loans	22.11	3	14
Rural electrification and telephone	2.52	41	1,620
Public Law 480 direct loans	81.79	179	219
Distance learning and medical link loan program	1.62	2	125
Rural community facility loan program	7.44	15	200
Rural business and industry loans	-1.56	-1	50
Rural telephone bank	1.33	2	175
Rural development loan fund	46.16	37	80
Rural water and waste disposal loan program	8.57	69	800
Education:			
Federal direct student loan program	0.35	53	15,101
Interior:			
Bureau of Reclamation loans	40.00	13	36
State Department: Repatriation loans	80.00	1	1
Transportation:			
Minority business resource center program	10.00	—*	15
Alameda Corridor project loan program	14.67	59	400
Treasury:			
Community development financial institutions fund	35.83	20	56
Veterans Affairs:			
Direct loan	46.77	—*	—*
Loan guarantee fund	1.56	14	894
Guaranty and indemnity fund	0.95	13	1,417
Vocational rehabilitation	1.75	—*	2
Native american veteran housing loan program	7.72	1	18
Other Independent Agencies:			
Export-Import Bank ²	4.00	136	3,396
Federal Emergency Management Agency:			
Disaster assistance	5.54	2	25
Small Business Administration:			
Disaster loans	7.90	66	667
Total	3.80	1,064	27,976

* Less than \$500,000.

¹ Additional information on credit reform subsidy rates is contained in the Federal Credit and Insurance Supplement to the budget for 1996.² Includes 1996 carryover budget authority.

Table 8-4. ESTIMATED 1997 SUBSIDY RATES, BUDGET AUTHORITY, AND LOAN LEVELS FOR LOAN GUARANTEES ¹

(In millions of dollars)

Agency and Program	1997 Weighted-average subsidy as a percent of disbursements	1997 Subsidy budget authority	1997 Estimated loan levels
Funds Appropriated to the President:			
Micro and small enterprise development	3.73	1	38
AID housing and other credit guarantees	11.83	5	41
Overseas Private Investment Corporation	2.50	65	2,250
Agriculture:			
Agricultural credit insurance fund	2.60	69	2,650
Commodity Credit Corporation: Export credits	8.00	390	5,500
Rural housing insurance fund	0.27	6	2,400
Rural business and industry loan program	0.94	7	750
Rural community facility loan program	0.41	—*	100
Commerce:			
Fishing vessel obligations	1.00	—*	25
Defense:			
Family Housing Improvement Fund	² 10.00	.....	.....
Education:			
Federal family education loan program	10.04	1,918	19,114
Health and Human Services:			
Health professions graduate student loan program	0.34	—*	140
Housing and Urban Development:			
Community development (Sec. 108)	2.30	46	2,000
Federal Housing Administration general and special risk	1.06	³ 41	⁴ 12,933
Federal Housing Administration mutual mortgage	-2.88	-1,255	70,721
GNMA secondary mortgage guarantees .....	.....	.....	110,000
Indian housing guarantee	8.13	3	37
Interior:			
Indian loan guaranty and insurance fund	13.00	5	35
Transportation:			
Title XI maritime guaranteed loans	7	40	800
Veterans Affairs:			
Guaranty and indemnity fund	1.47	361	24,547
Loan guaranty fund	15.04	—*	1
Other Independent Agencies:			
Export-Import Bank ⁵	4.45	636	14,294
Small Business Administration:			
Business Loans	2.68	203	11,653
Total ⁴	9.50	2,660	280,030

* Less than \$500,00.

¹ Additional information on credit reform subsidy rates is contained in the Federal Credit and Insurance Supplement to the budget for Fiscal Year 1996.² The subsidy rate is an estimated weighted average subsidy rate. Actual rates will be calculated on a transaction by transaction basis at the time of loan obligation.³ Subsidy BA represents the net amount resulting from new loans in both positive and negative subsidy programs. Since appropriations requested are for the gross amount of subsidy BA for positive subsidy programs (to be offset by the negative subsidy), the BA amount in this table does not represent the total gross appropriations request.⁴ Loan levels do not include standby commitment authority and therefore do not match levels requested in appropriations.⁵ Includes 1996 carryover budget authority.

Table 8-5. SUMMARY OF FEDERAL DIRECT LOANS AND LOAN GUARANTEES

(In billions of dollars)

	Actual			Estimate	
	1993	1994	1995	1996	1997
Direct Loans:					
Obligations	22.1	22.7	30.9	34.4	45.4
Disbursements	27.1	19.3	22	27.7	34.7
Subsidy budget authority	2.1	2.8	2.6	1.6	1.0
Loan Guarantees:					
Commitments	169.9	204.1	138.5	179.0	172.0
Lender Disbursements	144.3	194.2	117.9	139.2	152
Subsidy budget authority	4.1	2.6	5.1	4.4	3.7

Table 8-6. NEW DIRECT LOAN OBLIGATIONS AND GUARANTEED LOAN COMMITMENTS BY FUNCTION

(In millions of dollars)

Function	Direct loan obligations			Guaranteed loan commitments		
	1995 actual	1996 estimate	1997 estimate	1995 actual	1996 estimate	1997 estimate
050 National Defense .....	.....	.....	.....	300	342	229
150 International affairs	2,476	3,992	4,067	14,354	17,906	18,624
270 Energy	1,320	1,426	1,620	.....	.....	.....
300 Natural resources and environment	16	33	36	.....	.....	.....
350 Agriculture	9,794	6,463	7,605	7,638	8,150	8,150
370 Commerce and housing credit ¹	2,496	2,537	5,536	71,057	105,263	97,707
400 Transportation	98	15	415	118	229	571
450 Community and regional development	1,427	1,052	1,952	2,366	2,360	2,885
500 Education, training, employment, and social services	11,547	16,317	21,770	19,960	20,433	19,114
550 Health .....	.....	.....	.....	275	210	140
600 Income security .....	.....	.....	.....	22	37	37
700 Veterans benefits and services	1,535	2,104	2,344	22,162	24,033	24,548
800 General government	147	379	.....	.....	.....	.....
990 Multiple functions	45	55	106	.....	.....	.....
Total	30,901	34,373	45,451	138,272	178,963	172,005
ADDENDUM						
Secondary guaranteed loans .....	.....	.....	.....	142,000	110,000	110,000

¹ Commitments by GNMA to guarantee securities that are backed by loans previously insured or guaranteed by the Federal Housing Administration, Department of Veterans Affairs, or Farmers Home Administration (secondary guarantees) are excluded from the totals and shown in the addendum.

Table 8-7. DIRECT LOAN WRITE-OFFS AND GUARANTEED LOAN TERMINATIONS FOR DEFAULTS

Agency or Program	In millions of dollars			As percentage of outstanding loans ¹		
	1995 actual	1996 estimate	1997 estimate	1995 actual	1996 estimate	1997 estimate
DIRECT LOANS						
Funds Appropriated to the President:						
Economic assistance loans	32	.....	.....	0.24	.....	.....
International debt reduction .....	.....	3	4	.....	0.67	0.92
Foreign military loans	94	39	39	1.11	0.47	0.48
Department of Agriculture:						
Rural electrification and telephone revolving fund	50	.....	.....	0.15	.....	.....
Agricultural credit insurance fund	579	515	520	4.79	4.58	5.04
Rural housing insurance fund	99	101	100	0.32	0.33	0.33
Public Law 480 Food Aid	168	.....	63	1.43	.....	0.54
Department of Education:						
Federal direct student loan program	14	12	52	0.49	0.15	0.27
Department of Commerce:						
Economic development revolving fund (EDA)	2	.....	.....	2.94	.....	.....
Department of Interior:						
Bureau of Indian Affairs direct loans	11	4	4	17.74	14.81	7.41
Department of Veterans Affairs:						
Veterans housing programs	23	12	19	1.81	0.79	0.96
Independent Agencies:						
Small Business Administration	346	296	260	3.07	2.6	2.11
Export-Import Bank	45	.....	.....	.60	.....	.....
Total, direct loan writeoffs	1,463	982	1,061	.....	.....	.....
GUARANTEED LOANS						
Funds Appropriated to the President						
Housing and other credit guaranty programs	10	25	25	0.49	1.25	1.28
Overseas Private Investment Corporation	19	14	15	1.54	0.51	0.36
Microenterprise and other development guaranteed .....	.....	1	1	.....	2.22	1.25
Assistance for the New Independent States of the Soviet Union .....	.....	.....	8	.....	.....	14.55
CCC export credit guarantees	1,167	579	693	22.96	7.19	6.91
Foreign military loans	9	7	2	0.14	0.11	0.03
Department of Agriculture:						
Agricultural credit insurance fund	18	17	12	0.29	0.25	0.15
Rural development insurance fund	21	27	23	3.48	4.86	4.98
Rural housing insurance fund	1	11	14	22.00	46.00	54.00
Rural water and waste water disposal fund	1	.....	.....	0.20	100.00	.....
Rural community facility loans fund .....	.....	54	.....	.....	59.34	.....
Rural business and industry loans .....	.....	1	1	.....	0.05	0.06
Department of Education:						
Federal family education loans	1,286	1,767	2,384	3.10	2.62	2.78
Department of Interior:						
Indian loan guaranty and insurance fund	4	7	9	1.89	3.20	3.85
Department of Housing and Urban Development:						
FHA-General and special risk guaranteed loans	1,033	1,956	1,875	1.24	2.34	2.16
FHA-mutual mortgage and cooperative housing loans	3,969	3,658	4,124	1.25	1.10	1.17
Department of Transportation:						
MARAD ship financing fund	8	49	49	0.46	2.40	1.92
Department of Veterans Affairs:						
Veterans housing programs	1,664	2,500	2,360	1.07	1.55	1.34
Independent Agencies:						
Small business administration	635	629	816	2.40	2.16	2.36
Export-Import Bank	353	16	78	2.56	0.11	0.54
Total, guaranteed loan terminations for default	10,198	11,318	12,489	.....	.....	.....
DEFAULTED GUARANTEED LOANS THAT RESULT IN LOANS RECEIVABLE						
Funds Appropriated to the President:						
Housing and other credit guaranty programs	1	35	39	0.23	8.20	8.86
Foreign military loans	31	10	23	4.61	1.49	3.42
Department of Education:						
Federal family education loans	30	5	10	2.38	4.21	4.60

Table 8-7. DIRECT LOAN WRITE-OFFS AND GUARANTEED LOAN TERMINATIONS FOR DEFAULTS—Continued

Agency or Program	In millions of dollars			As percentage of outstanding loans ¹		
	1995 actual	1996 estimate	1997 estimate	1995 actual	1996 estimate	1997 estimate
Department of Housing and Urban Development:						
FHA-mutual mortgage and cooperative housing loans	139	851	510	3.23	32.21	53.80
FHA-general and special risk guaranteed loans	321	2,376	1,752	6.07	66.31	92.50
Department of Health and Human Services:						
Health professions guaranteed student loans	8	13	13	2.06	3.20	2.95
Department of Veterans Affairs:						
Veterans housing programs	584	693	711	37.58	45.56	49.4
Independent Agencies:						
Small Business Administration	40	84	184	2.45	4.50	7.76
Total, writeoffs of loans receivable	1,447	4,067	3,903	.....	.....	.....
Grand Total	13,108	16,637	17,453	.....	.....	.....

¹ Average of loans outstanding over year.

Table 8–8. APPROPRIATIONS ACTS LIMITATIONS ON CREDIT LOAN LEVELS

(In millions of dollars)

Agency or Program	1995 Actual	Estimate	
		1996	1997
LIMITATIONS ON DIRECT LOAN OBLIGATIONS			
Funds Appropriated to the President:			
Foreign military financing	558	544	370
Agriculture: ¹			
Farm Service Agency:			
Agricultural credit insurance fund	564	763	546
Rural Utilities Service:			
Rural electric and telephone	1,320	1,426	1,620
Rural telephone bank	175	175	175
Distance learning and medical link loans			125
Rural development insurance fund ¹	1,131		
Rural water and waste disposal loans		547	800
Rural Housing Service:			
Rural housing insurance fund	1,472	1,223	1,668
Rural community facility loans		208	200
Rural Business—Cooperative Service:			
Rural development loan fund	85	38	80
Rural economic development loans	13	14	14
Rural business and industry loans			50
Foreign Assistance Programs:			
Public Law 480 direct credit	303	291	219
Housing and Urban Development:			
FHA-General and special risk	220	120	120
FHA-Mutual mortgage insurance	180	200	200
Interior:			
Bureau of Reclamation direct loans	23	37	36
Indian direct loan	11		
State Department:			
Repatriation Loans	1	1	1
Transportation:			
Alameda Corridor project improvement			400
High priority corridors	40		
Orange County (CA) toll road	100	20	
Minority business resource center	15	15	15
Veterans Affairs:			
Direct loans	1		
Vocational rehabilitation	2	2	2
FEMA—Disaster assistance	175	36	25
Total, limitations on direct loan obligations	6,389	5,660	6,666
LIMITATIONS ON GUARANTEED LOAN COMMITMENTS			
Funds Appropriated to the President:			
Loan guarantees to Israel	2,000	2,000	2,000
Assistance for the New Independent States of the Former Soviet Union		106	
Agriculture:			
Agricultural credit insurance fund	1,938	2,450	2,650
Rural development insurance fund	575	50	
Rural business and industry loan fund		700	750
Rural housing insurance fund	1,049	1,700	2,400
Rural community facility loan fund		75	100
Education:			
Historically black colleges/universities	357		
Health and Human Services:			
Health professions graduate student loan insurance	275	210	140
Housing and Urban Development:			
FHA—General and special risk	20,885	17,400	17,400
FHA—Mutual mortgage insurance	100,000	110,000	110,000
Community development loan guarantees	2,054	1,500	2,000
Indian housing loan guarantee	22	37	37

Table 8–8. APPROPRIATIONS ACTS LIMITATIONS ON CREDIT LOAN LEVELS—Continued
(In millions of dollars)

Agency or Program	1995 Actual	Estimate	
		1996	1997
Interior:			
Indian loan guaranty and insurance	47	35	35
Total, limitations on guaranteed loan commitments	129,202	136,263	137,512
ADDENDUM			
Secondary guaranteed loan commitment limitations:			
GNMA, mortgage-backed securities	142,000	110,000	110,000

¹ In 1995, this included water and waste, community facility, and business and industry funds.

Table 8–9. DIRECT LOAN TRANSACTIONS OF THE FEDERAL GOVERNMENT
(in millions of dollars)

Agency or Program	1995 actual	Estimate	
		1996	1997
Funds Appropriated to the President			
International Security Assistance			
Foreign military loan liquidating account:			
Obligations			
Loan disbursements	461	30	9
Change in outstandings	– 716	– 943	– 886
Outstandings	7,911	6,968	6,082
Foreign military financing direct loan financing account:			
Obligations	558	544	370
Loan disbursements	266	743	829
Change in outstandings	266	733	807
Outstandings	539	1,272	2,079
Military debt reduction financing account:			
Obligations			
Loan disbursements		15	4
Change in outstandings		15	4
Outstandings		15	19
Multilateral Assistance			
International organizations and programs:			
Obligations			
Loan disbursements			
Change in outstandings	– 2	– 2	– 2
Outstandings	36	34	32
Agency for International Development			
Economic assistance loans—liquidating account:			
Obligations			
Loan disbursements	11	13	
Change in outstandings	– 486	– 599	– 616
Outstandings	13,279	12,680	12,064
Debt reduction, financing account:			
Obligations			
Loan disbursements		51	47
Change in outstandings	– 47	– 6	– 10
Outstandings	453	447	437
Private sector revolving fund liquidating account:			
Obligations			
Loan disbursements			
Change in outstandings	– 1	– 4	
Outstandings	7	3	3
Microenterprise and other development credit direct loan financing account:			
Obligations	1	1	1
Loan disbursements		3	1
Change in outstandings		3	
Outstandings	1	4	4
Overseas Private Investment Corporation			
Overseas Private Investment Corporation liquidating account:			
Obligations			
Loan disbursements			
Change in outstandings	– 11	– 5	– 6
Outstandings	28	23	17
Overseas private investment corporation direct loan financing account:			
Obligations	15	200	85
Loan disbursements	46	62	75
Change in outstandings	45	61	74
Outstandings	53	114	188
Department of Agriculture			
Farm Service Agency			
Agricultural credit insurance fund liquidating account:			
Obligations			
Loan disbursements	4	3	3
Change in outstandings	– 1,082	– 1,174	– 1,174
Outstandings	10,426	9,252	8,078
Agricultural credit insurance fund direct loan financing account:			
Obligations	564	763	546
Loan disbursements	583	813	777
Change in outstandings	143	328	247
Outstandings	1,655	1,983	2,230
Commodity credit corporation fund: ¹			
Obligations	9,230	5,700	7,059
Loan disbursements	9,230	5,700	7,059
Change in outstandings	– 343	– 665	186
Outstandings	2,786	2,121	2,307
Rural Utilities Service			
Rural communication development fund liquidating account:			
Obligations			
Loan disbursements			
Change in outstandings	– 1	– 1	– 1
Outstandings	10	9	8
Distance learning and medical link direct loan financing account:			
Obligations			125
Loan disbursements			38
Change in outstandings			38
Outstandings			38
Rural development insurance fund liquidating account:			
Obligations			
Loan disbursements	65	29	24
Change in outstandings	– 127	– 159	– 158
Outstandings	4,471	4,312	4,154
Rural electrification and telephone direct loan financing account:			
Obligations	1,320	1,426	1,620
Loan disbursements	830	1,192	1,275
Change in outstandings	787	1,155	1,208
Outstandings	2,740	3,895	5,103
Rural telephone bank direct loan financing account:			
Obligations	175	175	175
Loan disbursements	37	223	179
Change in outstandings	33	220	176
Outstandings	118	338	514
Rural development insurance fund direct loan financing account:			
Obligations	1,004		
Loan disbursements	608		
Change in outstandings	593	– 1,218	
Outstandings	1,218		
Rural water and waste disposal loans direct financing account:			
Obligations		547	800
Loan disbursements		600	677
Change in outstandings		1,567	655
Outstandings		1,567	2,222

Table 8-9. DIRECT LOAN TRANSACTIONS OF THE FEDERAL GOVERNMENT—Continued
(in millions of dollars)

Agency or Program	1995 actual	Estimate	
		1996	1997
Rural electrification and telephone revolving fund liquidating account:			
Obligations			
Loan disbursements	432	227	178
Change in outstandings	-998	-1,326	-1,153
Outstandings	33,101	31,775	30,622
Rural telephone bank liquidating account:			
Obligations			
Loan disbursements	36	33	33
Change in outstandings	-45	-60	-61
Outstandings	1,414	1,354	1,293
Rural Housing			
Rural housing insurance fund liquidating account:			
Obligations			
Loan disbursements	9	5	1
Change in outstandings	-1,163	-1,233	-1,214
Outstandings	23,675	22,442	21,228
Rural housing insurance fund direct loan financing account:			
Obligations	1,162	1,223	1,668
Loan disbursements	1,584	1,252	1,567
Change in outstandings	1,491	1,145	1,404
Outstandings	6,797	7,942	9,346
Rural community facility loans direct financing account:			
Obligations		208	200
Loan disbursements		134	161
Change in outstandings		366	149
Outstandings		366	515
Rural Business-Cooperative Service			
Rural economic development liquidating account:			
Obligations			
Loan disbursements		1	
Change in outstandings	-1		-2
Outstandings	8	8	6
Rural economic development loan direct financing account:			
Obligations	12	14	14
Loan disbursements	12	11	12
Change in outstandings	10	7	7
Outstandings	30	37	44
Rural development loan fund direct loan financing account:			
Obligations	85	38	80
Loan disbursements	47	63	57
Change in outstandings	47	63	56
Outstandings	74	137	193
Rural business and industry direct loans financing account:			
Obligations			50
Loan disbursements			12
Change in outstandings			12
Outstandings			12
Rural development loan fund liquidating account:			
Obligations			
Loan disbursements	5	3	2
Change in outstandings		-1	-2
Outstandings	85	84	82
Foreign Agricultural Service			
Expenses, Public Law 480, foreign assistance programs, Agriculture liquidating account:			
Obligations			
Loan disbursements			
Change in outstandings	-118	-272	-255
Outstandings	10,697	10,425	10,170
P.L. 480 Direct credit financing account:			
Obligations	303	291	219
Loan disbursements	186	270	191
Change in outstandings	175	270	145
Outstandings	1,024	1,294	1,439
P.L. 480 Title I Food for Progress Credits, financing account:			
Obligations			
Loan disbursements	52		
Change in outstandings	52		
Outstandings	508	508	508
Debt reduction—financing account:			
Obligations			
Loan disbursements			
Change in outstandings	-1	-1	-2
Outstandings	66	65	63
Department of Commerce			
Economic Development Administration			
Economic development revolving fund liquidating account :			
Obligations			
Loan disbursements			
Change in outstandings	-7	-7	-6
Outstandings	68	61	55
Department of Defense—Military			
Revolving and Management Funds			
Defense business operations fund:			
Obligations			
Loan disbursements			
Change in outstandings	-47	-49	-75
Outstandings	1,433	1,384	1,309
Department of Education			
Office of Postsecondary Education			
Student financial assistance:			
Obligations			
Loan disbursements			
Change in outstandings	-136	2	3
Outstandings	187	189	192
Higher education facilities loans:			
Obligations			
Loan disbursements			
Change in outstandings	-7	-6	-6
Outstandings	55	49	43
College housing and academic facilities loans liquidating account:			
Obligations			
Loan disbursements	4	4	4
Change in outstandings	2	2	1
Outstandings	138	140	141
College housing loans:			
Obligations			
Loan disbursements			
Change in outstandings	-35	-35	-32
Outstandings	484	449	417

Table 8-9. DIRECT LOAN TRANSACTIONS OF THE FEDERAL GOVERNMENT—Continued
(in millions of dollars)

Agency or Program	1995 actual	Estimate		Agency or Program	1995 actual	Estimate	
		1996	1997			1996	1997
College housing and academic facilities direct loan financing account:				Flexible Subsidy Fund:			
Obligations				Obligations			
Loan disbursements	6	13	9	Loan disbursements	126	159	56
Change in outstandings	6	13	9	Change in outstandings	125	157	54
Outstandings	7	20	29	Outstandings	584	741	795
Federal direct student loan program, financing account:				FHA mutual mortgage and cooperative housing insurance funds liquidating account:			
Obligations	11,547	16,317	21,770	Obligations			
Loan disbursements	2,332	9,600	13,763	Loan disbursements			
Change in outstandings	2,324	9,417	13,213	Change in outstandings	-2	-2	-2
Outstandings	2,801	12,218	25,431	Outstandings	15	13	11
Department of Energy				FHA general and special risk insurance funds liquidating account:			
Power Marketing Administration				Obligations			
Bonneville Power Administration fund:				Loan disbursements			
Obligations				Change in outstandings	-5	-6	-6
Loan disbursements				Outstandings	107	101	95
Change in outstandings				FHA-General and special risk direct loan financing account:			
Outstandings	3	3	3	Obligations		120	120
Department of Health and Human Services				Loan disbursements		120	120
Health Resources and Services Administration				Change in outstandings		120	120
Health Resources and Services:				Outstandings		120	240
Obligations				Housing for the elderly or handicapped fund liquidating account:			
Loan disbursements	17	17	18	Obligations			
Change in outstandings	266	3	4	Loan disbursements	7	192	
Outstandings	797	800	804	Change in outstandings	-131	131	-63
Health loan funds:				Outstandings	8,331	8,462	8,399
Obligations				FHA-Mutual mortgage insurance direct loan financing account:			
Loan disbursements	2	1	1	Obligations		200	200
Change in outstandings	-19	-11	-10	Loan disbursements		200	200
Outstandings	45	34	24	Change in outstandings		200	199
Department of Housing and Urban Development				Outstandings		200	399
Public and Indian Housing Programs				Government National Mortgage Association			
Low-rent public housing—loans and other expenses :				Guarantees of mortgage-backed securities liquidating account:			
Obligations				Obligations			
Loan disbursements				Loan disbursements	149	314	378
Change in outstandings	-58	-62	-65	Change in outstandings	-16	27	49
Outstandings	1,689	1,627	1,562	Outstandings	333	360	409
Community Planning and Development				Department of the Interior			
Revolving fund (liquidating programs):				Bureau of Reclamation			
Obligations				Bureau of reclamation loan liquidating account:			
Loan disbursements				Obligations			
Change in outstandings	-58	-52	-46	Loan disbursements			
Outstandings	388	336	290	Change in outstandings		-3	-3
Community development loan guarantees liquidating account:				Outstandings	83	80	77
Obligations				Bureau of Reclamation direct loan financing account:			
Loan disbursements				Obligations	16	33	36
Change in outstandings	-21	-20	-15	Loan disbursements	12	28	34
Outstandings	89	69	54	Change in outstandings	12	28	34
Housing Programs				Outstandings	31	59	93
Nonprofit sponsor assistance liquidating account:				Emergency fund:			
Obligations				Obligations			
Loan disbursements				Loan disbursements			
Change in outstandings				Change in outstandings	-1	-1	-1
Outstandings	1	1	1	Outstandings	6	5	4

Table 8-9. DIRECT LOAN TRANSACTIONS OF THE FEDERAL GOVERNMENT—Continued
(in millions of dollars)

Agency or Program	1995 actual	Estimate	
		1996	1997
National Park Service			
Construction:			
Obligations			
Loan disbursements			
Change in outstandings	-1		-1
Outstandings	7	7	6
Bureau of Indian Affairs			
Revolving fund for loans liquidating account:			
Obligations			
Loan disbursements			
Change in outstandings	-9	-7	-8
Outstandings	67	60	52
Indian loan guaranty and insurance fund liquidating account:			
Obligations			
Loan disbursements	3	4	4
Change in outstandings	3		
Outstandings	40	40	40
Indian direct loan financing account:			
Obligations	11		
Loan disbursements	-14		
Change in outstandings	-5	-5	-3
Outstandings	22	17	14
Insular Affairs			
Assistance to territories:			
Obligations			
Loan disbursements			
Change in outstandings	-1	-1	-1
Outstandings	21	20	19
Department of State			
Administration of Foreign Affairs			
Repatriation loans financing account:			
Obligations	1	1	1
Loan disbursements		1	1
Change in outstandings		1	1
Outstandings	1	2	3
Department of Transportation			
Federal Highway Administration			
Alameda corridor project direct loan financing account:			
Obligations			400
Loan disbursements			
Change in outstandings			
Outstandings			
Orange County (CA) toll road demonstration project direct loan financing account:			
Obligations			24
Loan disbursements			24
Change in outstandings			25
Outstandings			25
High priority corridors loan financing account:			
Obligations	40		
Loan disbursements	37		
Change in outstandings	37		-37
Outstandings	37	37	
Right-of-way revolving fund liquidating account:			
Obligations	43		
Loan disbursements	26	24	25
Change in outstandings	2	-6	-5
Outstandings	153	147	142
Federal Railroad Administration			
Amtrak corridor improvement loans liquidating account:			
Obligations			
Loan disbursements			
Change in outstandings		-1	-1
Outstandings	7	6	5
Amtrak corridor improvement direct loan financing account:			
Obligations			
Loan disbursements		2	
Change in outstandings		2	
Outstandings	3	5	5
Railroad rehabilitation and improvement liquidating account:			
Obligations			
Loan disbursements			
Change in outstandings	-3	-3	-3
Outstandings	67	64	61
Railroad rehabilitation and improvement direct loan financing account:			
Obligations			
Loan disbursements	6		
Change in outstandings	4		
Outstandings	4	4	4
Maritime Administration			
Federal ship financing fund liquidating account:			
Obligations			
Loan disbursements	8	50	50
Change in outstandings	-185	42	43
Outstandings	33	75	118
Office of the Secretary			
Minority business resource center direct loan financing account:			
Obligations	15	15	15
Loan disbursements	9	21	15
Change in outstandings	2		
Outstandings	9	9	9
Department of the Treasury			
Departmental Offices			
Community development financial institutions fund direct loan financing account:			
Obligations		34	56
Loan disbursements		7	25
Change in outstandings		7	25
Outstandings		7	32
Department of Veterans Affairs			
Veterans Benefits Administration			
Guaranty and indemnity fund liquidating account:			
Obligations			
Loan disbursements	4		
Change in outstandings	-9	-1	
Outstandings	13	12	12
Direct loan revolving fund liquidating account:			
Obligations			
Loan disbursements			
Change in outstandings	-3	-3	-3
Outstandings	14	11	8

Table 8-9. DIRECT LOAN TRANSACTIONS OF THE FEDERAL GOVERNMENT—Continued
(in millions of dollars)

Agency or Program	1995 actual	Estimate	
		1996	1997
Loan guaranty revolving fund liquidating account:			
Obligations			
Loan disbursements	24		
Change in outstandings	-100	-44	-44
Outstandings	528	484	440
Vocational rehabilitation direct loan financing account:			
Obligations	2	2	2
Loan disbursements	2	2	2
Change in outstandings			
Outstandings	1	1	1
Education loan fund liquidating account:			
Obligations			
Loan disbursements			
Change in outstandings			-1
Outstandings	3	3	2
Loan guaranty direct loan financing account:			
Obligations	923	885	894
Loan disbursements	933	885	894
Change in outstandings	45	196	191
Outstandings	473	669	860
Guaranty and indemnity direct loan financing account:			
Obligations	604	1,197	1,417
Loan disbursements	604	1,197	1,417
Change in outstandings	77	319	256
Outstandings	227	546	802
Direct loan financing account:			
Obligations	6	20	31
Loan disbursements	6	20	31
Change in outstandings	5	21	31
Outstandings	6	27	58
Environmental Protection Agency			
Environmental Protection Agency			
Abatement, control, and compliance direct loan liquidating account:			
Obligations			
Loan disbursements	2	1	
Change in outstandings	-7	-8	-9
Outstandings	96	88	79
Abatement, control, and compliance direct loan financing account:			
Obligations			
Loan disbursements	21	10	6
Change in outstandings	17	5	1
Outstandings	60	65	66
Small Business Administration			
Small Business Administration			
Business direct loan financing account:			
Obligations	23	60	2,684
Loan disbursements	33	41	1,367
Change in outstandings	10	11	1,267
Outstandings	126	137	1,404
Disaster direct loan financing account:			
Obligations	1,311	932	1,260
Loan disbursements	1,811	923	1,057
Change in outstandings	1,748	734	797
Outstandings	7,157	7,891	8,688
Disaster loan fund liquidating account:			
Obligations			
Loan disbursements	5		
Change in outstandings	-277	-298	-252
Outstandings	1,918	1,620	1,368
Business loan fund liquidating account:			
Obligations			
Loan disbursements	199	226	159
Change in outstandings	-530	-208	-229
Outstandings	2,037	1,829	1,600
Other Independent Agencies			
District of Columbia			
Loans to the District of Columbia for capital projects:			
Obligations			
Loan disbursements			
Change in outstandings	-12	-13	-12
Outstandings	75	62	50
Repayable advances to the District of Columbia direct loan financing account:			
Obligations	147	379	
Loan disbursements	147	379	
Change in outstandings	147	232	-379
Outstandings	147	379	
Export-Import Bank of the United States			
Export-Import Bank of the United States liquidating account:			
Obligations			
Loan disbursements	193	140	102
Change in outstandings	-520	-1,538	-829
Outstandings	6,138	4,600	3,771
Debt reduction financing account:			
Obligations			
Loan disbursements		64	30
Change in outstandings		64	30
Outstandings		64	94
Export-Import Bank direct loan financing account:			
Obligations	1,598	2,955	3,396
Loan disbursements	673	1,388	1,573
Change in outstandings	580	1,056	1,222
Outstandings	1,407	2,463	3,685
Farm Credit System Financial Assistance Corporation			
Financial assistance corporation assistance fund, liquidating account:			
Obligations			
Loan disbursements			
Change in outstandings	-48	-41	-42
Outstandings	1,010	969	927
Bank Insurance			
Bank insurance fund:			
Obligations			
Loan disbursements			
Change in outstandings	-5	-19	
Outstandings	132	113	113
FSLIC Resolution			
FSLIC resolution fund:			
Obligations			
Loan disbursements			
Change in outstandings	-31	-32	-31
Outstandings	95	63	32
Federal Emergency Management Agency			
Disaster assistance direct loan liquidating account:			
Obligations			
Loan disbursements			
Change in outstandings		-44	
Outstandings	59	15	15

Table 8-9. DIRECT LOAN TRANSACTIONS OF THE FEDERAL GOVERNMENT—Continued
(in millions of dollars)

Agency or Program	1995 actual	Estimate	
		1996	1997
Disaster assistance direct loan financing account:			
Obligations	140	36	25
Loan disbursements	44	112	25
Change in outstandings	14	89	-48
Outstandings	90	179	131
National Credit Union Administration			
Credit union share insurance fund:			
Obligations		2	2
Loan disbursements		5	1
Change in outstandings	-3	2	
Outstandings		2	2
Central liquidity facility:			
Obligations			
Loan disbursements			
Change in outstandings			
Outstandings			
Community development credit union revolving loan fund:			
Obligations			
Loan disbursements	2	2	2
Change in outstandings			
Outstandings	5	5	5
Tennessee Valley Authority			
Tennessee Valley Authority fund:			
Obligations	45	55	106
Loan disbursements	45	55	106
Change in outstandings	-6	2	31
Outstandings	150	152	183
Total, Direct loan transactions:			
Obligations	30,901	34,373	45,451
Loan disbursements	21,982	27,683	34,710
Change in outstandings	1,628	8,621	14,964
Outstandings	163,323	171,944	186,908

¹ CCC direct loans for crop price support, by law, are not subject to credit reform treatment.

Table 8–10. GUARANTEED LOAN TRANSACTIONS OF THE FEDERAL GOVERNMENT
(in millions of dollars)

Agency or Program	1995 actual	Estimate		Agency or Program	1995 actual	Estimate	
		1996	1997			1996	1997
Funds Appropriated to the President				Department of Agriculture			
International Security Assistance				Farm Service Agency			
Foreign military loan liquidating account:				Agricultural credit insurance fund liquidating account:			
Commitments				Commitments			
New guaranteed loans				New guaranteed loans	3		
Change in outstandings	– 536	– 442	– 395	Change in outstandings	– 674	– 317	– 212
Outstandings	6,610	6,168	5,773	Outstandings	1,316	999	787
Agency for International Development				Agricultural credit insurance fund guaranteed loan financing account:			
Loan guarantees to Israel financing account:				Commitments	1,938	2,450	2,650
Commitments	1,783	1,940	2,000	New guaranteed loans	1,878	1,922	2,573
New guaranteed loans	1,783	1,940	2,000	Change in outstandings	1,029	827	1,296
Change in outstandings	1,783	1,940	2,000	Outstandings	4,979	5,806	7,102
Outstandings	5,346	7,286	9,286	Commodity credit corporation export guarantee financing account:			
Housing and other credit guaranty programs liquidating account:				Commitments	5,700	5,700	5,500
Commitments				New guaranteed loans	2,518	5,700	5,500
New guaranteed loans	34	27	50	Change in outstandings	– 5,888	3,091	2,048
Change in outstandings	– 28	– 45	– 24	Outstandings	4,874	7,965	10,013
Outstandings	2,009	1,964	1,940	Commodity credit corporation guaranteed loans liquidating account:			
Private sector revolving fund liquidating account:				Commitments			
Commitments				New guaranteed loans			
New guaranteed loans				Change in outstandings	– 1,723	– 114	– 75
Change in outstandings			– 17	Outstandings	206	92	17
Outstandings	19	19	2	Natural Resources Conservation Service			
Microenterprise and other development guaranteed loan financing account:				Agricultural resource conservation demonstration guaranteed loan financing account:			
Commitments	48	38	38	Commitments			
New guaranteed loans	4	20	36	New guaranteed loans			
Change in outstandings	4	19	35	Change in outstandings			
Outstandings	26	45	80	Outstandings	17	17	17
Housing and other credit guaranty programs guaranteed loan financing account:				Rural Utilities Service			
Commitments	148	41	42	Rural communication development fund liquidating account:			
New guaranteed loans	120	131	112	Commitments			
Change in outstandings	120	131	112	New guaranteed loans			
Outstandings	179	310	422	Change in outstandings			
Assistance for the New Independent States of the Former Soviet Union: Ukraine export credit insurance financing account:				Outstandings	5	5	5
Commitments		106		Rural development insurance fund liquidating account:			
New guaranteed loans		90	16	Commitments			
Change in outstandings		90	– 35	New guaranteed loans	7	19	
Outstandings		90	55	Change in outstandings	– 102	– 94	– 94
Overseas Private Investment Corporation				Outstandings	602	508	414
Overseas Private Investment Corporation liquidating account:				Rural water and waste water disposal guaranteed loan financing account:			
Commitments				Commitments	475	50	
New guaranteed loans				New guaranteed loans	217	3	12
Change in outstandings	– 69	– 69	– 61	Change in outstandings	183	– 484	12
Outstandings	287	218	157	Outstandings	494	10	22
Overseas private investment corporation guaranteed loan financing account:				Rural electrification and telephone revolving fund liquidating account:			
Commitments	1,891	2,000	2,250	Commitments			
New guaranteed loans	575	1,627	1,765	New guaranteed loans			
Change in outstandings	561	1,602	1,465	Change in outstandings	– 17	– 20	– 22
Outstandings	948	2,550	4,015	Outstandings	687	667	645

Table 8-10. GUARANTEED LOAN TRANSACTIONS OF THE FEDERAL GOVERNMENT—Continued
(in millions of dollars)

Agency or Program	1995 actual	Estimate	
		1996	1997
Rural Housing Service			
Rural housing insurance fund liquidating account:			
Commitments			
New guaranteed loans			
Change in outstandings	-5	-4	-3
Outstandings	36	32	29
Rural housing insurance fund guaranteed loan financing account:			
Commitments	1,049	1,700	2,400
New guaranteed loans	859	1,466	2,161
Change in outstandings	809	1,373	2,009
Outstandings	2,085	3,458	5,467
Rural community facility loans guaranteed financing account:			
Commitments		75	100
New guaranteed loans		40	45
Change in outstandings		91	40
Outstandings		91	131
Rural Business-Cooperative Service			
Rural business and industry loans guaranteed financing account:			
Commitments		700	750
New guaranteed loans		515	638
Change in outstandings		1,183	507
Outstandings		1,183	1,690
Department of Commerce			
Economic Development Administration			
Economic development revolving fund liquidating account:			
Commitments			
New guaranteed loans			
Change in outstandings	-11	-2	-1
Outstandings	19	17	16
National Oceanic and Atmospheric Administration			
Fishing vessel obligations guarantees financing account:			
Commitments	75	25	
New guaranteed loans	32	25	
Change in outstandings	5	19	-6
Outstandings	54	73	67
Federal ship financing fund, fishing vessels liquidating account:			
Commitments			
New guaranteed loans			
Change in outstandings	-21		
Outstandings	142	142	142
Department of Education			
Office of Postsecondary Education			
Federal family education loan liquidating account:			
Commitments			
New guaranteed loans	19	19	5
Change in outstandings	-6,801	-6,801	-5,188
Outstandings	29,573	22,772	17,584
Federal family education loan program, financing account:			
Commitments	19,603	20,433	19,114
New guaranteed loans	20,321	18,369	18,587
Change in outstandings	16,289	18,620	13,447
Outstandings	56,557	75,177	88,624
Historically Black College and University Capital financing—Financing account:			
Commitments	357		
New guaranteed loans		65	75
Change in outstandings		64	74
Outstandings		64	138
Department of Health and Human Services			
Health Resources and Services Administration			
Health Resources and Services:			
Commitments			
New guaranteed loans			
Change in outstandings	-2	-1	-1
Outstandings	11	10	9
Health professions graduate student loan guaranteed loan financing account:			
Commitments	275	210	140
New guaranteed loans	275	210	140
Change in outstandings	274	207	132
Outstandings	1,163	1,370	1,502
Health professions graduate student loan insurance fund liquidating account:			
Commitments			
New guaranteed loans			
Change in outstandings	-64	-68	-73
Outstandings	1,657	1,589	1,516
Health loan funds:			
Commitments			
New guaranteed loans			
Change in outstandings	-48	-39	-31
Outstandings	261	222	191
Department of Housing and Urban Development			
Public and Indian Housing Programs			
Low-rent public housing—loans and other expenses:			
Commitments			
New guaranteed loans			
Change in outstandings	-281	-300	-325
Outstandings	4,132	3,832	3,507
Indian housing loan guarantee—financing account:			
Commitments	22	37	37
New guaranteed loans		28	33
Change in outstandings		28	33
Outstandings		28	61
Community Planning and Development			
Revolving fund (liquidating programs) :			
Commitments			
New guaranteed loans			
Change in outstandings	-4	-1	-1
Outstandings	4	3	2
Community development loan guarantees financing account:			
Commitments	1,844	1,500	2,000
New guaranteed loans	243	1,672	1,750
Change in outstandings	202	1,632	1,685
Outstandings	317	1,949	3,634
Community development loan guarantees liquidating account:			
Commitments			
New guaranteed loans	27	20	15
Change in outstandings	-51	-50	-45
Outstandings	246	196	151

Table 8–10. GUARANTEED LOAN TRANSACTIONS OF THE FEDERAL GOVERNMENT—Continued
(in millions of dollars)

Agency or Program	1995 actual	Estimate		Agency or Program	1995 actual	Estimate	
		1996	1997			1996	1997
Housing Programs				Maritime Administration			
FHA mutual mortgage and cooperative housing insurance funds liquidating account:				Federal ship financing fund liquidating account:			
Commitments				Commitments			
New guaranteed loans				New guaranteed loans			
Change in outstandings	– 22,543	– 14,610	– 10,526	Change in outstandings	– 166	– 199	– 179
Outstandings	96,145	81,535	71,009	Outstandings	981	782	603
FHA general and special risk insurance funds liquidating account:				Maritime guaranteed loan (Title XI) financing account:			
Commitments				Commitments	418	571	800
New guaranteed loans				New guaranteed loans	418	571	800
Change in outstandings	– 5,025	– 2,971	– 2,210	Change in outstandings	428	515	694
Outstandings	47,729	44,758	42,548	Outstandings	742	1,257	1,951
FHA-General and special risk guaranteed loan financing account:				Department of Veterans Affairs			
Commitments	10,138	11,824	12,933	Veterans Benefits Administration			
New guaranteed loans	9,622	9,971	10,741	Guaranty and indemnity fund liquidating account:			
Change in outstandings	9,229	3,515	5,417	Commitments			
Outstandings	35,457	38,972	44,389	New guaranteed loans			
Mutual mortgage insurance guaranteed loan financing account:				Change in outstandings	– 1,099	– 1,102	– 1,022
Commitments	50,323	77,793	70,721	Outstandings	16,569	15,467	14,445
New guaranteed loans	40,142	51,543	58,592	Loan guaranty revolving fund liquidating account:			
Change in outstandings	37,831	30,358	28,530	Commitments			
Outstandings	222,021	252,379	280,909	New guaranteed loans			
Government National Mortgage Association				Change in outstandings	– 22,891	– 8,466	– 3,319
Guarantees of mortgage-backed securities liquidating account:				Outstandings	15,774	7,308	3,989
Commitments				Loan guaranty guaranteed loan financing account:			
New guaranteed loans	63,727	94,440	81,575	Commitments	1	1	1
Change in outstandings	18,858	25,749	9,354	New guaranteed loans	1	1	1
Outstandings	463,848	489,597	498,951	Change in outstandings	834	674	685
Guarantees of mortgage-backed securities financing account:				Outstandings	836	1,510	2,195
Commitments	142,000	110,000	110,000	Guaranty and indemnity guaranteed loan financing account:			
New guaranteed loans				Commitments	22,161	24,032	24,547
Change in outstandings				New guaranteed loans	22,161	24,032	24,547
Outstandings				Change in outstandings	20,213	21,462	21,716
Department of the Interior				Outstandings	121,307	142,769	164,485
Bureau of Indian Affairs				Small Business Administration			
Indian loan guaranty and insurance fund liquidating account:				Small Business Administration			
Commitments				Pollution control equipment fund liquidating account:			
New guaranteed loans				Commitments			
Change in outstandings	– 43	– 25	– 19	New guaranteed loans			
Outstandings	103	78	59	Change in outstandings	– 11	– 9	– 8
Indian guaranteed loan financing account:				Outstandings	95	86	78
Commitments	47	35	35	Business guaranteed loan financing account:			
New guaranteed loans	67	43	50	Commitments	9,709	13,921	11,653
Change in outstandings	55	32	34	New guaranteed loans	8,402	10,413	11,864
Outstandings	109	141	175	Change in outstandings	5,611	6,607	6,789
Department of Transportation				Outstandings	18,618	25,225	32,014
Federal Aviation Administration				Business loan fund liquidating account:			
Aircraft purchase loan guarantee program:				Commitments			
Commitments				New guaranteed loans	4		
New guaranteed loans				Change in outstandings	– 1,804	– 1,302	– 1,030
Change in outstandings	– 3	– 2		Outstandings	7,675	6,373	5,343
Outstandings	2						

Table 8-10. GUARANTEED LOAN TRANSACTIONS OF THE FEDERAL GOVERNMENT—Continued
(in millions of dollars)

Agency or Program	1995 actual	Estimate	
		1996	1997
Other Independent Agencies			
Export-Import Bank of the United States			
Export-Import Bank of the United States liquidating account:			
Commitments			
New guaranteed loans	288	300	275
Change in outstandings	- 1,010	- 1,193	- 913
Outstandings	4,010	2,817	1,904
Export-Import Bank guaranteed loan financing account:			
Commitments	10,267	13,781	14,294
New guaranteed loans	7,854	8,455	9,618
Change in outstandings	1,990	423	323
Outstandings	13,736	14,159	14,482
FSLIC Resolution			
FSLIC resolution fund:			
Commitments			
New guaranteed loans			
Change in outstandings	- 360		
Outstandings			

Agency or Program	1995 actual	Estimate	
		1996	1997
Tennessee Valley Authority			
Tennessee Valley Authority fund:			
Commitments			
New guaranteed loans	1		1
Change in outstandings			
Outstandings			
Subtotal, Guaranteed loans (gross):			
Commitments	280,272	288,963	282,005
New guaranteed loans	181,602	233,677	233,577
Change in outstandings	45,028	81,522	72,602
Outstandings	1,190,618	1,272,140	1,344,742
Less, secondary guaranteed loans: ¹			
GNMA guarantees of FmHA/VA/FHA pools:			
Commitments	- 142,000	- 110,000	- 110,000
New guaranteed loans	- 63,727	- 94,440	- 81,575
Change in outstandings	- 18,858	- 25,749	- 9,354
Outstandings	- 463,848	- 489,597	- 498,951
Total, primary guaranteed loans: ²			
Commitments	138,272	178,963	172,005
New guaranteed loans	117,875	139,237	152,002
Change in outstandings	26,170	55,773	63,248
Outstandings	726,770	782,543	845,791

¹Loans guaranteed by FHA, VA, or FmHA are included above. GNMA places a secondary guarantee on these loans, so they are deducted here to avoid double counting.

²When guaranteed loans result in loans receivable, they are shown in the direct loan table.

Table 8-11. LENDING AND BORROWING BY GOVERNMENT-SPONSORED ENTERPRISES (GSEs)

(In millions of dollars)

Enterprise		1995 actual	Estimate	
			1996	1997
LENDING				
Student Loan Marketing Association	Obligations	11,021	10,553	10,441
	New transactions	11,021	10,553	10,441
	Net change	3,565	— 3,434	— 1,866
	Outstandings	41,636	38,202	36,336
Federal National Mortgage Association:				
Corporation Accounts	Obligations	44,501	64,526	69,773
	New transactions	44,574	63,686	67,815
	Net change	28,608	31,691	33,202
	Outstandings	250,374	282,065	315,267
Mortgage-backed securities	Obligations	— 51,497	129,045	129,247
	New transactions	89,130	129,045	129,247
	Net change	36,073	58,802	54,204
	Outstandings	559,585	618,387	672,591
Farm Credit System:				
Banks for cooperatives	Obligations	8,690	9,976	10,076
	New transactions	8,690	9,976	10,076
	Net change	619	205	208
	Outstandings	2,273	2,478	2,686
Farm Credit Banks	Obligations	22,036	22,103	22,436
	New transactions	22,036	22,492	22,880
	Net change	345	568	542
	Outstandings	14,231	14,800	15,600
Agricultural credit banks	Obligations	42,644	44,000	45,000
	New transactions	42,638	44,000	45,000
	Net change	1,357	569	800
	Outstandings	14,231	14,800	15,600
Federal Home Loan Bank system:				
Federal home loan banks	Obligations	724,349	725,000	725,000
	New transactions	724,349	725,000	725,000
	Net change	5,561	— 1,628	.....
	Outstandings	122,128	120,500	120,500
Federal Home Loan Mortgage Corporation:				
Corporation accounts	Obligations	37,389	48,876	41,615
	New transactions	37,389	48,876	41,615
	Net change	28,373	32,502	24,854
	Outstandings	95,052	127,554	152,408
Participation certificate pools	Obligations	70,071	110,877	108,540
	New transactions	70,071	110,877	108,540
	Net change	— 6,626	21,017	30,493
	Outstandings	457,046	478,063	508,556
Subtotal, lending (gross)	Obligations	909,204	1,164,956	1,162,128
	New transactions	1,049,898	1,164,505	1,160,614
	Net change	97,875	140,292	142,437
	Outstandings	1,578,860	1,719,152	1,861,589
Less guaranteed loans held as direct loans by:				
Federal National Mortgage Association	Net change	2,247	— 346	— 122
	Outstandings	23,027	22,681	22,559
Student Loan Marketing Association ¹	Net change	3,565	— 3,434	— 1,866
	Outstandings	41,636	38,202	36,336
Other	Net change	3,405	.....	.....
	Outstandings	7,860	7,860	7,860
Total GSE lending (net)	Obligations	909,204	1,164,956	1,162,128
	New transactions	1,049,898	1,164,505	1,160,614
	Net change	88,658	144,072	144,425
	Outstandings	1,506,337	1,650,409	1,794,834
BORROWING				
Student Loan Marketing Association ¹	Net change	1,980	— 5,915	— 1,558
	Outstandings	51,672	45,757	44,199
Federal National Mortgage Association	Net change	73,945	91,506	90,068
	Outstandings	836,777	928,283	1,018,351
Farm Credit System:				
Banks for cooperatives	Net change	759	— 7	— 32
	Outstandings	2,458	2,451	2,419
Farm credit banks	Net change	922	734	1,083
	Outstandings	39,041	39,775	40,858
Agricultural credit banks	Net change	1,583	465	884
	Outstanding	15,319	15,784	16,668
Federal Housing Finance Board:				
Federal home loan banks	Net change	63,027	— 9,406	.....
	Outstandings	226,406	217,000	217,000
The Financing Corporation	Net change	1	1	2
	Outstandings	8,141	8,142	8,144
Resolution Funding Corporation	Net change	— 3	— 2	— 2

Table 8-11. LENDING AND BORROWING BY GOVERNMENT-SPONSORED ENTERPRISES (GSEs)—Continued
(In millions of dollars)

Enterprise		1995 actual	Estimate	
			1996	1997
Federal Home Loan Mortgage Corporation	Outstandings	30,076	30,074	30,072
	Net change	21,038	50,536	62,449
	Outstandings	568,656	619,192	681,641
Subtotal, borrowing (gross)	Net change	163,252	127,912	152,894
	Outstandings	1,778,546	1,906,458	2,059,352
Less borrowing from other GSEs	Net change	-3,421	.....	.....
	Outstandings	36,387	36,387	36,387
Less investment in Federal Securities	Net change	-1,375	1,712	491
	Outstandings	8,674	10,386	10,877
Less borrowing for guaranteed loans held as direct loans by:				
Federal National Mortgage Association	Net change	2,247	-346	-122
	Outstandings	23,027	22,681	22,559
Student Loan Marketing Association ¹	Net change	3,565	-3,434	-1,866
	Outstandings	41,636	38,202	36,336
Other	Net change	3,935	.....	.....
	Outstandings	7,860	7,860	7,860
Total GSE borrowing (net)	Net change	158,301	129,980	154,391
	Outstandings	1,660,962	1,790,942	1,945,333

¹ All SLMA loans shown in the table above are guaranteed by the Federal Government and therefore also counted as guaranteed loans.